

CASE

NUMBER:

99-176

BEFORE THE
KENTUCKY PUBLIC SERVICE COMMISSION

CASE NO. 99-176

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RE: DELTA NATURAL GAS COMPANY

**PUBLIC SERVICE
COMMISSION**

Pursuant to notice duly given, the above-styled matter came to be heard October 29, 1999, at 9:00 a.m. in the Hearing Room of the Kentucky Public Service Commission, 730 Schenkel Lane, Frankfort, Kentucky 40601; The Honorable B. J. Helton presiding.

VOLUME II OF II

C O P Y

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BEFORE THE
KENTUCKY PUBLIC SERVICE COMMISSION
CASE NO. 99-176

RE: DELTA NATURAL GAS COMPANY

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PUBLIC SERVICE COMMISSION

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1 CHAIRMAN HELTON:

2 Mr. Wuetcher:

3 MR. WUETCHER:

4 Thank you.

5

6 The witness, WILLIAM STEVEN SEELYE, having
7 been previously sworn, testified as follows:

8

CROSS EXAMINATION

9 BY MR. WUETCHER:

10 Q Good morning Mr. Seelye.

11 A Good morning Mr. Wuetcher.

12 Q Let me start off with some loose ends and
13 then work from there. First, has Delta
14 performed a marginal cost analysis to support
15 its position that the wages and salaries vary
16 directly with the number of customers?

17 A No.

18 Q Okay. Has Delta had any study--never mind.
19 Has Delta performed a marginal cost analysis
20 to support its expense to revenue ratio?

21 A No.

22 Q To your knowledge, has Delta's 1999 bad debt
23 expense increased or decreased when compared
24 to the same period in 1998?

1 A Could you repeat the question, I--
2 Q Okay, let me--to your knowledge has Delta's
3 1999 bad debt expense increased when compared
4 to the same period in 1998?

5 A I don't know.

6 Q Okay. Are you aware of any change in the bad
7 debt expense from 1999 compared to 1998?

8 A The only thing I'm aware of is the
9 information that was cited by Mr. Henkes in
10 his testimony.

11 Q Okay.

12 A But I'm not aware of any other changes other
13 than what has been discussed in the past day.

14 Q All right. Could Delta provide to the
15 Commission a monthly comparison of Delta's
16 bad debt expense for 1998 and 1999?

17 MR. WATT:

18 Was that a question, did we or could we?

19 MR. WUETCHER:

20 Could you?

21 MR. WATT:

22 A monthly comparison, is that what you
23 said?

24

1 MR. WUETCHER:

2 Yes, sir, if you could compare the, I
3 guess, the bad debt expense for each
4 month in 1998 and then show what the
5 expense would be for each month of 1999
6 up to wherever the knowledge is current.
7 I assume that would be to the end of
8 September?

9 MR. WATT:

10 Okay.

11 Q Mr. Seelye, does the current practice of including
12 customer deposit interest and operating expenses
13 in not reducing rate base by the customer deposit
14 balance allow double recovery of interest paid on
15 customer deposits?

16 A I don't believe it does. I believe that the
17 methodology that is used is consistent with
18 Commission practice of not reducing rate base
19 by that. It is a different component that is
20 not, typically, in Kentucky reduced by rate
21 base, so I don't believe it does allow double
22 recovery.

23 Q In your cost of service analysis other, than
24 the development of a regression analysis for

1 distribution cost, how did you determine the
2 method to functionalize the various segments
3 of cost between demand and commodity?

4 A Between demand and commodity the costs that were
5 separated between demand and commodity in the cost
6 of service study related to storage. The storage
7 component was allocated on the basis of winter
8 season commodity, and the reason for that is that
9 storage is utilized throughout the winter season,
10 therefore, commodity was used for that component.
11 The rest of Delta's cost in--that are subject to
12 this rate case, are primarily fixed costs and,
13 therefore, the balance of the costs are allocated
14 or classified as either customer related or demand
15 related. The other major component of cost which
16 is not being considered here that is commodity
17 related is gas supply cost. But, again, that is
18 not included in the base rates that we are dealing
19 with, therefore, it wasn't dealt with in the cost
20 of service study. But the other fixed costs were
21 allocated between customer and demand.

22 Q Would you agree with Mr. Galligan's
23 modifications to the allocation--let me start
24 back over again. Would you agree that Mr.

1 Galligan's modifications to the allocation
2 process has the effect of substantially
3 reducing the cost to the residential customer
4 while significantly raising the cost of
5 serving commercial and industrial customers?

6 A Yes.

7 Q Okay. Assuming the Commission were to accept
8 Mr. Galligan's recommendations and establish
9 rates based on his results, what would be the
10 effect on Delta's operations in the long run?

11 A On Delta's operations, I'm not sure it would
12 have a direct impact on Delta's operations,
13 per se. It would change--the purpose of the
14 cost of service study is to determine an
15 appropriate way to allocate costs and if
16 Delta changes its rates, I'm not sure if it
17 ends up affecting the rates that it charges
18 its customers, I think Delta will continue to
19 operate in the same manner that it is
20 currently operating in. It is just a rate
21 design. It would have an effect, possibly,
22 on the way that rates are designed.
23 Therefore, I don't believe it would have an
24 effect on operations.

1 Q Maybe you didn't understand my question,
2 probably because I worded it a little poorly.
3 Let's assume the Commission accepts Mr.
4 Galligan's recommendations and then, based on
5 his cost of service study results, designed
6 rates that reflect those costs, then in that
7 circumstance, would there be an impact on
8 Delta's long run operations? We are now
9 changing the rates based upon the
10 recommendations made by the Attorney General.

11 A Let me think about that for a second. On its
12 operations, it would change the rates that
13 are being charged to the customers,
14 obviously. And it would change, perhaps, the
15 way the gas is perceived or marketed by the
16 customer. What impact it would have on the
17 overall operations, it would prob--it would
18 make commercial and industrial service less
19 competitive. And in an area where they are
20 trying to encourage economic development in
21 rural areas, I think it would hinder that
22 effort. Therefore, it would have an effect
23 on the overall business, Delta's overall
24 business, because it would--as Mr. Hazelrigg

1 testified earlier, Delta is already having
2 trouble in terms of being competitive with
3 commercial industrial customers. By
4 increasing significantly commercial
5 industrial rates that aren't competitive, it
6 would even put more pressure on them and they
7 probably couldn't add any high load factor
8 gas load and it would probably hinder
9 economic development in rural Kentucky.

10 Q In your opinion, how valid is the theory
11 underlying the zero intercept methodology?
12 That is a single variable linear relationship
13 between the unit cost of mains and collars
14 per foot and the gas flow capability of the
15 pipe, which is proportionate to its diameter?

16 A I think it is a valid methodology.

17 Q Could you elaborate on it? Is it an accepted
18 industry standard?

19 A It is probably the accepted industry
20 standard, if you look around the country, for
21 classifying mains as well as in the electric
22 business conductors, transformers,
23 underground conductors. It is often used
24 where it's a little less certain is in the

1 case of electric poles, but it is a very--it
2 is a standard methodology that is accepted in
3 the industry, probably, the methodology that
4 you use more often than not. At one time the
5 minimum system was probably used more
6 frequently but the zero intercept has
7 overtaken that in most jurisdictions that I'm
8 aware of.

9 Q Let's kind of elaborate on that issue, very
10 briefly. When you state that it is a valid
11 method from an industry standard or from an
12 economic standard, econometrics--econometrics
13 standard, would it be valid from that point?

14 A Yes, it is also valid from an econometrics
15 standpoint. What you are trying to do is
16 determine the cost, the fixed cost, the non-
17 demand related cost of providing services to
18 customers, therefore, what you are trying to
19 do is to determine the amount of cost that do
20 not vary with the size of the pipe in this
21 case, with--is related to the load carrying
22 capability of that pipe. Therefore, it
23 represents the fixed customer related portion
24 of the mains, therefore, it is theoretically

1 sound as well as a standard industry
2 methodology.

3 Q Why not a multi-variant specification, more
4 than one theory--independent variable be
5 used?

6 A I'm not aware of any other variant that could
7 be used, it--this is going to complicate it a
8 little bit, but the methodology that we do
9 use is a multi-variant regression. And the
10 weighted--I knew I'd get some unusual looks
11 on this one here--but the model that is being
12 used, because it is weighted regression,
13 there are two variables in it, one variable
14 is the size of the pipe, the square root of
15 N, that is a varied in the model. The other
16 varied is the square root of N times the size
17 of the main, therefore, the model we use is,
18 in fact, a multi-varied regression analysis.
19 Now, there are not two econometric variables
20 that are utilized, therefore, it is not a
21 multi-varied analysis in the sense that you
22 are probably asking the question.

23 Q Concerning the independent variable of the size of
24 the pipe in diameter, is it valid to treat plastic

1 pipe and steel pipe as the same variable?
2 A I believe it is because that reflects what is
3 embedded in their system. In order to do
4 otherwise you would have to--some methodologies
5 that I've seen brings it up to current levels
6 which would assume that all pipe is plastic, but
7 that doesn't reflect the reality on--or the
8 embedded cost on Delta's system. Therefore, this
9 methodology takes into consideration all the pipe
10 that exists on the system, both standard steel
11 pipe as well as plastic. And, as a matter of
12 fact, on the other studies I've done on gas
13 included like wrought iron pipe which goes way
14 back. But all of those are included on the books
15 of the utility, therefore, it should be used.

16 Q Why is the unit cost of three inch plastic
17 pipe so low relative to other sizes?

18 A Plastic--there is probably more--is it lower
19 than--let me get that out--can you refer to
20 an exhibit or something that I can look at?

21 Q It is your Exhibit 4-1.

22 A Okay. The question again is?

23 Q Well, let me go ahead and refer you--if you
24 look at Exhibit 4-1 and you go down to the

1 distribution main pipe, three inch plastic,
2 and then go over to unit cost per foot, that
3 appears to be significantly lower than the
4 other sizes of pipe that immediately surround
5 it.

6 A I can only speculate.

7 Q Okay.

8 A The--what I would guess is that in the past
9 several years Delta has installed quite a lot
10 of four inch pipe, therefore, they have not
11 recently installed as much three inch pipe in
12 order to provide--on mains. Therefore, the
13 three inch plastic pipe is probably of an
14 older vintage than the four inch plastic
15 pipe, therefore, the four inch plastic pipe
16 is probably more representative of current
17 prices and is weighted up because they have
18 installed more of that recently. That would
19 be my guess. I could probably--I'm getting
20 some nods from Delta so I suspect that is the
21 correct answer.

22 Q Would that explanation also explain why steel
23 pipes cost less than their plastic counter
24 parts of the same size?

1 A That's one element of it, yes, because that--
2 the steel pipe is an older pipe, most
3 utilities put in plastic pipe now days as
4 opposed to steel pipe. So, it is a more
5 current--more current cost.

6 Q Are the costs that are set forth in Exhibit
7 4-1 adjusted for inflation?

8 A No.

9 Q They are actual costs?

10 A These are actual book costs, embedded cost on
11 the books.

12 Q In preparing the exhibit or obtaining the
13 results that are set forth in Exhibit 4-1,
14 were there any adjustments made of a time
15 series nature?

16 A Of a time--no.

17 Q What, if any, tests were done to check for
18 heteroskedasticity, let me spell that because
19 I'm probably mispronouncing it, h-e-t-e-r-o-
20 s-k-e-d-a-s-t-i-c-i-t-y?

21 A Right. I didn't do any tests to check for
22 heteroskedasticity. Heteroskedasticity is
23 inherent whenever you calculate averages.
24 And when you are taking average unit cost the

1 variance of the--the air variance, if you
2 will, will be in direct proportion to one
3 over n, therefore, it is inherent any time
4 that you are taking average data. That is in
5 the standard literature on regression
6 analysis.

7 Q Okay. Let me refer you to page 13 of your
8 direct testimony, I believe this is the
9 direct testimony in the 99-176.

10 A You said 13?

11 Q Yes, sir.

12 A I'm there.

13 Q Okay. At that page you indicate that the
14 correlation coefficient R square for mains is
15 0.8286?

16 A Yes.

17 Q And that this measures the goodness of fifth
18 of the equation?

19 A Yes.

20 Q Is it not the case that this is the
21 coefficient of determination, not the
22 correlation coefficient?

23 A I thought R was the correlation--coefficient
 of determination and R squared was the

1 correlation coefficient, do I have that
2 reversed? Do I have it reversed, okay.

3 Q Let me go ahead now and move back to the Alternate
4 Regulation Plan that you propose. Can you tell me
5 when was the Prime Group retained to develop the
6 Alternative Regulation Plan?

7 A Which month?

8 Q Well, generally which month?

9 A Okay. I believe it was December of last
10 year, so it was December 1998, I believe is
11 when it was.

12 Q Okay. When the Prime Group was retained I take it
13 --were there any other consultants besides
14 yourself that--

15 A Involved in it?

16 Q Yes, sir.

17 A No.

18 Q Okay. What instructions were you given by
19 Delta concerning development of the
20 Alternative Regulation Plan?

21 A Instructions may be a strong word, but what
22 we were asked to look at is the
23 implementation of a model that was similar to
24 the Alagasco model.

1 Q Okay. You were not given any guidance to
2 review the plans in other states aside from
3 those in Alabama?

4 A Not specifically. Now, let me say that Delta
5 indicated that they were open to other
6 considerations and I did look--did a Lexus
7 search of other plans in other states and as
8 a part of doing that I didn't undercover a
9 lot. Okay. What I found in most
10 jurisdictions was more performance based rate
11 making mechanisms as opposed to what we were
12 considering Alternative Regulation Plans.
13 And the difference is that the performance
14 based rate making is not intended to take the
15 place fully of regulation. It would--it
16 wouldn't eliminate the need for a general
17 rate case. It would operate within the
18 consideration of certain performance based
19 measures. Okay, therefore, we found, in
20 fact, more of that in my Lexus search than
21 alternative regulation. What I did find is
22 some states are currently investigating,
23 considering alternative regulation. I also
24 found alternative regulation used heavily in

1 the telephone industry, especially, about ten
2 years ago there was quite a lot of
3 alternative regulation used there.

4 Q Well, let me interrupt you, when you say some
5 states were investigating it, then let's
6 explore your search for a second. What
7 states in particular did you review and,
8 following up on that, what particular
9 companies outside of the State of Alabama had
10 plans or were looking at plans?

11 A Okay. None had plans that were similar to
12 the one that we are looking at here but other
13 states that we looked at, Alabama had some,
14 Mississippi had one, and Alabama. Those are
15 the three states that I'm aware of that has--

16 Q I'm sorry, you said Alabama and Mississippi
17 and then said Alabama again.

18 A Oh, I'm sorry, Georgia.

19 Q Georgia.

20 A Georgia, I'm sorry, thinking Georgia and said
21 Alabama.

22 Q I'm not sure the--a Georgian would take
23 exception to that.

24 A They probably would.

- 1 Q Mr. Jennings mentioned Atlanta Gaslight
2 Company yesterday and, obviously, references
3 have been made to Alabama Power and Alagasco,
4 what other utilities besides those three?
- 5 A I believe it was Mississippi Power Company
6 has one as well. And theirs is completely
7 different and much, much more complicated.
- 8 Q Can you provide us with a copy of the
9 Mississippi Power Company's plan?
- 10 A I can probably get one, I'm not sure if I
11 currently have one, but the head of rates
12 used to--that is currently there used to work
13 for me at LG&E so I can contact him and get
14 that.
- 15 Q Outside of those three states, you found no
16 other--
- 17 A No other--I couldn't find any other states.
18 I'm aware of some mechanisms that were used
19 in the past that the experiment was put in
20 and they--for a few years and then it was
21 abandoned. There was one in New Jersey, I
22 believe, several years ago.
- 23 Q Could you provide us at least with the name
24 of the utility and the--if you have a case

1 reference to those utilities that had such a
2 plan and then either abandoned it or had a--
3 in any of those instances, was it a
4 circumstance where the state public utility
5 commission directed that the plan be
6 discontinued?

7 A Okay. I'll have to find that out. This is
8 based on recollection there.

9 Q Okay.

10 A And it was several years ago, I would review
11 literature, trade literature and I remember
12 that going on in New Jersey. And, like I
13 said, where I have seen more of it than any
14 other place is in the telephone industry.

15 MR. WATT:

16 Your Honor, may I confirm that I have
17 this request properly?

18 CHAIRMAN HELTON:

19 Sure.

20 MR. WATT:

21 Jerry, I've written down that you would
22 like to have the names of the utilities,
23 the case numbers and the reasons for the
24 abandonment of Alt Reg Plans?

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MR. WUETCHER:

No, we'd like to have the names of the utility.

MR. WATT:

Okay.

MR. WUETCHER:

The order, if there is such, in creating the--or approving the plan, if you can provide it, or at least a citation to the order so that we could obtain it either electronically or through that state commission. And then, if the plan were discontinued, if you could indicate whether it was discontinued at the request--at the utility's own decision or whether it was discontinued as a result of the state regulator and then a reference, if there is one, a citation to the decision of the utility regulator ordering that the plan be discontinued.

A Let me point out one thing about the New Jersey, I was surprised when I did my Lexus-- or it may be hard to find this because I did not uncover that when I did the Lexus search.

1 So, that may be a hard one to find, but we
2 will see if we can't do that.

3 Q Okay. To the extent that--I think,
4 primarily, what we are looking for at this
5 moment is just the extent of your review, so
6 we are certainly--while we would certainly
7 appreciate any new research you might want to
8 do, at least what--if you can review your
9 files as to what you have, have now and what
10 you had when you were planning the
11 alternative proposal?

12 A Yes, sir.

13 Q Let me make sure I understand. When you began
14 your work you were--were you looking at two
15 different options, PBR or alternative regulation
16 or focusing solely on alternative regulation?

17 A When we began our review, it was solely on
18 alternative regulation and not PBR. PBR, or
19 performance based elements, was a concept we
20 knew would come up and we were hoping to work
21 that out in a more consensual or
22 collaborative manner with all the parties.
23 And that is why it was not included in the
24 original filing, because we knew that that

1 could evolve in any of several directions.
2 And what we were primarily interested in was
3 alternative forms of regulation, something
4 that could, in effect, take the place of
5 standard rate case filings. And there is, in
6 our view, there is a big difference between
7 alternative regulation and PBR. But there is
8 no reason that the two can't work together.

9 Q Okay.

10 CHAIRMAN HELTON:

11 But by the same token, in the sense that
12 you are using alternative regulation,
13 what you were looking at was rate
14 stabilization plans and no other forms
15 of alternative regulation because there
16 are plenty of other forms of alternative
17 regulation?

18 A Yes, that's how we were defining and using the
19 term alternative regulation. That's how we were
20 looking at it.

21 Q When you were doing your search, did you
22 speak or interview any officials from other
23 utilities?

24 A From other utilities? I did speak with

1 people at Alabama Power Company and I have
2 since spoken--not when I was doing the
3 review, but I have since spoken with people
4 at Mississippi Power Company.

5 Q Okay. You did not speak with anyone from
6 Alagasco?

7 A No, I didn't, personally, no.

8 Q Did you speak with anyone from the regulatory
9 agencies that were overseeing the plan?

10 A Yes, I did.

11 Q Okay. Who--first, what commissions and then
12 if you could be a little bit more specific
13 and at least identify what position--

14 A Okay. The only commission that I spoke to or
15 commission staff, or commission that I spoke
16 to, I spoke to a staff member from the
17 Alabama Public Service Commission. And the
18 person I talked to there was Bob Reed.

19 Q And what was his involvement in--what is his
20 position with the Alabama Public Service
21 Commission and what was his involvement in
22 the development or implementation of the
23 plans?

24 A I'm not sure that he was involved in the

1 development, he didn't say. He is involved in the
2 ongoing implementation, the ongoing operation of
3 the mechanism. He is the supervisor in charge of
4 the gas program. There is a separate supervisor
5 over the electric program in the state and I
6 didn't talk to that individual. But Bob is the
7 person that is in charge of compliance, if you
8 will, of the mechanism. He is also in charge of
9 any reviews that are conducted of the mechanism.

10 Q When you say he is in charge, are you saying that
11 his division or people under him are in charge or
12 responsible?

13 A Yes, he and people that report to him are in
14 charge of monitoring the mechanism.

15 Q Do you know the extent of his personal
16 involvement in the monitoring?

17 A Yes, he is very involved in the monitoring of
18 it, and he is the person at the staff that
19 is--I was informed, it took me a little while
20 to get to the correct person because I called
21 a couple other people, or called one other
22 person and they said, oh, you need to talk to
23 Bob Reed and, therefore, I ended up with Bob
24 and he was very knowledgeable of it.

1 Q Okay. Aside from the officials you spoke
2 with at Alabama Power and the official at the
3 Alabama Public Service Commission, were there
4 any other persons that you consulted in the
5 development of your program outside of Delta
6 and your consulting group?

7 A No.

8 Q Okay. Would you agree with the statement
9 that, as originally proposed, Delta's plan
10 was a rate stabilization plan?

11 A Yes.

12 Q And it had no cost controls?

13 A Limited cost controls.

14 Q Would you say that the principal purpose was
15 to insure that Delta's rate of return would
16 be within a certain range?

17 A Yes, not go above that range or below that
18 range.

19 Q Okay. Did you draft or participate in the
20 drafting of the February 5, 1999, letter that
21 was part of the rate filing?

22 A I drafted that letter.

23 Q Okay. I think in the letter it refers to the
24 Alternative Rate Regulation as a method for the

1 Public Service Commission fulfilling its statutory
2 obligations under KRS 278.030?

3 A Yes, sir.

4 Q In your opinion, does the Public Service
5 Commission have a statutory obligation to insure
6 that a utility earns an authorized rate of return?

7 A I wouldn't characterize it exactly like that,
8 no.

9 Q Okay. Well, then, I guess--let me follow
10 that up by asking is it your opinion that the
11 PSC has merely the statutory duty to provide
12 the utility with an opportunity to earn a
13 reasonable rate of return?

14 A I would agree with that.

15 Q There is no duty then to insure that the
16 utility earns that rate of return?

17 A No, I agree with your statement.

18 Q Well, then, would you agree that it is the
19 responsibility of utility management to
20 insure that the rate of return is earned?

21 A Well, I think that is a little bit more
22 complex issue, because the--if they--the
23 regulatory environment can be such where
24 they--it may be very difficult, in spite of

1 the efforts of traditional regulation, to
2 provide a reasonable opportunity to earn a
3 return. So, I think it is more complex than
4 just to say that it is completely under
5 management control, because the traditional
6 regulation, as well as it has worked in
7 Kentucky, I think there are other
8 alternatives that could provide a better
9 means for providing an opportunity for the
10 utility to earn a fair, just and reasonable
11 return.

12 Q Well, would you agree that there are tools
13 available under the traditional system of
14 regulation that management can use to earn
15 the authorized rate of return?

16 A Yes.

17 Q And would that include a constant monitoring
18 of the utility's operations and finances?

19 A Yes.

20 Q Would that include, I guess, reviewing rates to
21 insure they adequately protect the utility's
22 financial integrity?

23 A Yes.

24 Q Would it also include taking corrective

1 actions when necessary, such as applying for
2 new rates or implementing cost cutting
3 procedures?

4 A Yes.

5 Q There are several benefits that are listed to
6 the Alternative Regulation proposal, and I
7 guess one of them that you list is that the
8 proposal will insure Delta's rate of return
9 is within authorized limits; correct?

10 A Yes.

11 Q How is that a benefit to either the public or
12 to the regulatory commission that is
13 overseeing the utility?

14 A Okay, that's a benefit to both the--for
15 everyone, I think, because it insures that
16 the utility in a very simple manner, and what
17 I mean by simple manner, in a very efficient
18 way, just stays within the range. Or does
19 not over-earn. You see a utility given
20 changes in the marginal cost can be in a
21 situation where at times they may have an
22 opportunity to over-earn. The mechanism, in
23 a very efficient way, allows the utility to
24 bring down its rates so that the rate of

1 return falls within that range. Therefore, I
2 think that is a real--a very real benefit
3 that is, to a large extent, I think, lost in
4 this case a little bit.

5 Q Well, to the extent that there is a
6 possible--well, I think you had discussed
7 this yesterday with Ms. Blackburn, and I
8 don't want to go into it very much--
9 Blackford, but I won't go into it very much,
10 but right now has the problem been the
11 regulated utility over-earning, in Delta's
12 case?

13 A In Delta's case, no.

14 Q Okay. To the extent that there were any type
15 of over-earning don't existing mechanisms--
16 well, aren't there existing mechanisms that
17 can prevent that or bring the utility back in
18 place?

19 A Yes, there are existing mechanisms, however, this
20 mechanism is much more efficient in doing that
21 because it is automatic. You don't have to have
22 as party file a complaint. The Commission doesn't
23 have to have a show cause case or something to
24 bring the utility in to reduce its rates, which in

1 a lot of jurisdictions isn't done very much
2 because of the complexity of a rate case and so
3 forth, for whatever reason. This is--this
4 provides a much more efficient way to bring the
5 utility's rate of return up or to bring it down,
6 to keep it within the range that is authorized by
7 the Commission.

8 Q And your assumption in stating that, though,
9 is that the automatic mechanisms are going to
10 be less costly than, for example, a PSC
11 review proceeding in an over-earnings case?

12 A That's one element of it, much more efficient
13 because it automatically does this.

14 Q Now, the other side to the insuring the rate
15 of return is it's, basically, a protection
16 for the utility is it not? The utility is
17 protected from under-earnings?

18 A Yes, that is an important element as well.

19 Q Okay. And aren't there also existing
20 mechanisms within the traditional framework
21 that will insure that? For example--

22 A Yes, filing a rate case.

23 Q Filing a rate case, how about simply, as we talked
24 about before, management's efforts to control

1 costs?

2 A Yes, that is as element.

3 Q How about weather normalization?

4 A Weather normalization is not a mechanism that
5 currently exists for Delta. Weather
6 normalization is something that could be
7 implemented and that would certainly help.
8 And in part it would take the place of some
9 of the things that would be accomplished
10 through the Alt Reg Plan.

11 Q You also stated that the proposed plan is
12 consistent with the priciplism of--with the
13 principle of gradualism, that being, I guess,
14 smaller rate increases annually than one
15 large increase?

16 A Yes.

17 Q In some respect, would the weather normalization
18 factor also do that?

19 A In making the comment that I made about
20 gradualism, I'm getting at a different point.
21 Weather normalization takes care of
22 fluctuations from year to year in weather.
23 Okay? The point I was making with respect to
24 gradualism is that utilities costs, they may

1 be in an increasing or decreasing mode rather
2 than allowing this either excess of earnings
3 to build up or a deficiency to build up
4 before a utility files a rate initiative or
5 before the company is called in to reduce
6 their rates, this provides a much more
7 gradual way of reflecting those costs into
8 rates.

9 Q The next benefit you list is that it is less
10 resource intensive?

11 A Yes, sir.

12 Q Okay. And I think you--under that you gave
13 four reasons, one is that the utility can
14 focus on its business and not regulatory
15 proceedings?

16 A Yes.

17 Q The company saves money because it has less costs
18 incurred because of these regulatory proceedings
19 are avoided?

20 A Yes.

21 Q The Commission saves resources and time because it
22 is not devoting resources towards a rate case; is
23 that correct?

24 A Yes.

1 Q And then there is, I guess, just as as general
2 comment you make, that it is less resource
3 intensive because this process is a less
4 adversarial process; is that right?

5 A Yes, presumably.

6 Q Would you agree that before any claim can be
7 made that the proposed plan results in a less
8 resource intensive process, all parties have
9 to know all the details of the process?

10 A I believe that is helpful if all parties
11 understand it. If all parties can work
12 together in a reasonable fashion, I think it
13 makes it work much better.

14 Q Well, let me step back on that so I--you said
15 that this is going to be--this plan will
16 produce a less resource intensive process.
17 But for us--for anyone to determine whether
18 it is going to be less resource intensive,
19 isn't it necessary to know the exact details
20 of the plan and how the review process is
21 going to be done before you can make that
22 claim?

23 A I agree in part. I believe that--yes, I'll
24 just agree with it, yes.

1 Q Okay. Well, would you agree that the plan,
2 as submitted, either in the first filing that
3 was made in 99-046 or as it was subsequently
4 filed in the general rate adjustment
5 proceeding, that it is lacking in a few
6 specifics?

7 A Yes, and we anticipated that those specifics
8 would be developed in the course of this
9 proceeding.

10 Q Well, let's go--I guess I'm just trying to
11 make sure I understand what is needed and
12 what is not there right--is there any
13 provision in the existing proposal that
14 relates to a prohibition against rate
15 adjustment filings while the plan is in
16 effect?

17 A No.

18 Q Okay. Is there any expiration date in the
19 proposed tariff?

20 A The expiration date was stated throughout
21 testimony and stated throughout data
22 requests. I don't believe that that needs to
23 be set forth in the tariff if it is in the
24 Commission's order approving it. But we

1 don't have any objection, Delta doesn't have
2 any objection of stating that in the tariff.
3 That is not any big deal. The tariff could
4 be modified to do that.

5 Q Okay. Were there any work sheets on the
6 calculation of the various components?

7 A Work sheets of the various components, yes.

8 Q Okay. As--well, let me--Delta used the
9 Alagasco plan as a model?

10 A Yes, yes.

11 Q Would you agree that there are detailed work
12 sheets in the Alagasco plan as to specific
13 expenses that would be removed, that those types
14 of work sheets are not in the Delta proposal?

15 A Yes. And, again, if I could elaborate on
16 that.

17 Q Sure.

18 A We anticipated that those--whatever
19 requirements that are necessary for the--that
20 the Commission feels necessary would be
21 developed throughout the course of this
22 proceeding. There are lots of things in the
23 Alagasco tariff that we, frankly, thought
24 would be presumptuous to even include in,

1 therefore, we didn't use a lot of it because
2 we didn't think it was appropriate. We
3 thought that throughout the course of this
4 proceeding that these items, whatever was
5 important, even things that may not be in the
6 Alagasco tariff, would be developed, fleshed
7 out, included in the tariff, whatever those
8 are.

9 Q Well, let me follow that up, because it
10 seemed like part of Delta's approach was to
11 put a proposal on the table and then have the
12 parties and the Commission staff and the
13 Commissioners kind of hash it out, to work to
14 some type of--and I hesitate to use the word,
15 but a collaborative process that comes to an
16 agreed result; is that correct?

17 A Yes.

18 Q Now--and I take it, based on your experience
19 that the Louisville Gas & Electric Company,
20 you have seen that work. Was that not the
21 case of how it was done with the demand side
22 management program?

23 A Yes, sir, it was, if I could elaborate. We
24 had very good experience working in a

1 collaborative manner at LG&E.

2 Q Okay. And I'm sorry to interrupt, but since
3 I'm trying to impose a time limit on what
4 I'm--

5 A I'm sorry.

6 Q In the LG&E case you had several diverse parties,
7 did you not?

8 A Yes.

9 Q You had the industrial customers?

10 A Yes.

11 Q You had the Attorney General?

12 A Yes.

13 Q You had several low income groups?

14 A Yes.

15 Q You had several local governmental units?

16 A Yes.

17 Q Okay. And in this case, now, you have only
18 got the Attorney General you really have to
19 deal with; is that correct?

20 A That's correct.

21 Q Okay. In that case, was not the plan
22 developed and then submitted to the
23 Commission still as a proposal before--so it
24 was fully fleshed out before the Commission

1 even saw it?

2 A Yes.

3 Q Okay. Was there any attempt made by Delta to
4 at least flesh out the procedure with the
5 Attorney General's Office before the plan was
6 filed with the Commission?

7 A I can't remember the exact timing on this,
8 but there was certainly an effort to flesh
9 this out. I can't remember if the meeting to
10 do that was before or after the filing. It
11 seems to me that we tried to set up a meeting
12 before we even filed it, but I can't remember
13 the exact sequence in it. The intention was
14 certainly to try to work it out in a
15 collaborative manner, though, whether it was
16 done before or after the filing.

17 Q Well, would you agree, for example, that some
18 of the provisions that might be--that are
19 contained in the Alagasco plan that are
20 designed to meet the consumer protection
21 advocate's plans are missing from this one,
22 and the only specific I've got noted is there
23 is a provision in the Alagasco plan that
24 allows for filings to be made directly--or

1 requires filings to me made or copies of
2 filings to be submitted to the Attorney
3 General's Office of the Consumer
4 Representative?

5 A Yes, that is the type of thing that is almost
6 always presumed in Kentucky. And we would,
7 as a matter of course, provide the Attorney
8 General with any filing we made. We didn't
9 view that as being necessary but it is
10 nothing that I think anybody would object to.

11 Q Well, to the extent that you had the Alagasco
12 plan there and you were lifting significant
13 portions from it, are you saying we should
14 not read anything from the fact that those
15 provisions that were not lifted from it
16 suggested in any way that the utility did not
17 intend to--

18 A Yes, that's correct. We tried--let me say,
19 we used the Alagasco model as a regulatory
20 model, okay. We didn't try to capture all
21 the nuances of the terms and conditions that
22 were set forth in the tariff. We generally--
23 Randall Walker and I, who developed the
24 tariff language together, we developed it

1 along the lines that we are familiar with in
2 Kentucky. We--Randall and I have developed
3 several tariffs and--that are similar to
4 this, for example, the DSM, the demand side
5 management tariff that you referred to, and
6 the gas supply cost tariff, we tried to
7 implement terms and conditions that are more
8 standard in Kentucky tariffs as opposed to
9 language that they may be used to in
10 Alabama. You should not read into that that
11 we have any problem with certain--some of
12 those terms and conditions that are in there,
13 many of them are reasonable.

14 Q You would agree that, to the extent that a
15 reservation has been made by the utility as
16 to whether it will implement or accept any
17 changes made by the Commission to the
18 proposed tariff when there is, what could be
19 considered, an area where there are as lot of
20 specifics missing, presents some problems for
21 the regulators? If you are presenting a
22 proposal on the table which you intend for
23 the regulator to change or add additional
24 portions to, and yet reserving the right to

1 not accept it if it is not enacted in whole,
2 presents a problem for the regulator, doesn't
3 it?

4 A Yes, I believe that is a function of the formality
5 of what we are doing and, to a large extent, what
6 we are faced with is a situation where you file
7 something formally and it has got to be reviewed
8 formally without any give and take throughout the
9 proceeding, therefore, I think it does present a
10 problem to regulators. I think it presents a
11 problem to the utility. I think it is the rigid--
12 the formality that we must operate in and this
13 case presents a problem as far as trying to
14 collaborately work things out. I agree, it is a
15 problem but that is just the way it is in a formal
16 proceeding.

17 Q Okay. As far as review of how the mechanism
18 is going to work, if we could go through that
19 because I'm a little bit unclear on that. As
20 it currently stands there is a three year
21 review that Delta is proposing; is that
22 right?

23 A Yes.

24 Q Now, initially, that three year review will

1 be to determine whether the plan should go
2 forward or just be ended?

3 A Yes.

4 Q And I assume that if the Commission were to
5 determine that the plan goes forward, then
6 this would be a three year cycle in which
7 every three years the utility would come in
8 for a review.

9 A I think that would make some sense.

10 Q Okay. And as far as that review, what--I'm
11 not sure I understood from your responses to
12 Ms. Blackford yesterday, but will these three
13 year reviews basically be rate cases?

14 A They would be an evaluation of base rates.
15 They could be done--this review would,
16 hopefully, be done in a more collaborative,
17 consensual manner than a formal rate case.
18 But, ultimately, it may end up being a formal
19 evaluation rate case, if you will, concerning
20 Delta's base rates.

21 Q Well, in making a review of the base rates,
22 would the--would a cost of service study be
23 required?

24 A I would envision a cost of service study

1 being done as a part of that review, yes.

2 Q Okay. How about a study--I assume a cost--a
3 study of the cost of capital would also
4 necessarily be required?

5 A The exception to that is that if you could
6 collaboratively work it out. If you--if
7 there is a disagreement on that cost of--a
8 cost of capital would have to be evaluated.

9 Q How does that differ from an existing rate
10 case to the extent the parties meet and say,
11 let's stipulate what we are in agreement on?

12 A It may not be a lot different than a rate
13 case on that three year review. It depends
14 on--it depends on if the mechanism--if
15 everybody can get comfortable with the
16 mechanism, you may be able to work it out,
17 sit down at the table ad work it out outside
18 of the standard framework. But it may not be
19 that way, because I think the danger of doing
20 otherwise is, obviously, due process issues.
21 If there is a difference in opinion with
22 respect to the cost of capital, it may have
23 to be a formal review and it may not be a lot
24 different than a rate case.

1 VICE CHAIRMAN HOLMES:

2 You're saying conceivably that if this
3 was adopted, you could have a rate case
4 every three years?

5 A We hope not, but that is possible.

6 Q Is that--has that been the experience in Alabama?

7 A No, it has not been the experience in Alabama.

8 Q And has that been because the parties have
9 reached an agreement on the mechanism?

10 A Yes. The parties, in talking to Bob Reed,
11 the parties feel comfortable with the
12 mechanism. The mechanism has been in place a
13 number of years, the commission feels very
14 comfortable with the utility's cost
15 structure. There has been some issues that
16 come up over the years, corrective measures
17 have been taken, changes have been made to
18 the modification--or the mechanism to make it
19 more workable and they view it as a dynamic
20 changing process.

21 Q Okay. We have talked about the three year
22 review, let's go back now, there is going to
23 be--your plan envisions an annual review for
24 certain of the components. Now, what issues

1 are going to be involved with the annual
2 review? I take it some of the things that
3 will be missing will be the cost of service
4 study?

5 A Yes.

6 Q The--

7 A ROE determination.

8 Q Okay. Any other provisions that will be
9 missing that would normally be found in the
10 three year review?

11 A Yes, rate design provisions, you wouldn't--unless
12 there was some need--Mr. Jennings spoke to earlier
13 that there could be a need for some modification,
14 a new tariff, for example, a new tariff sheet.
15 Because the marketplace is very dynamic and there
16 may be some changes. But, normally, that wouldn't
17 be a part of the annual review.

18 Q You had mentioned earlier, in response to why
19 the annual review would not be as
20 adversarial, you mentioned that you don't get
21 into non-recurring charge issues in the
22 annual review as opposed to what you might
23 get into in a general rate adjustment case?

24 A Yes, sir.

1 Q Does that really present a problem? I mean,
2 have you found that non-recurring charges are
3 really a major issue in most rate
4 proceedings?

5 A Well, they haven't been in this rate
6 proceeding and earlier rate proceedings that
7 I've been involved in, they were major
8 issues. We would spend a day on a non-
9 recurring charge.

10 Q Isn't it--doesn't the utility have the
11 option, though, at any point in time of
12 filing as separate application on a non-
13 recurring charge outside of a rate
14 proceeding?

15 A You are limited to one of those I believe. I
16 can't remember how many you are limited to,
17 one or two in between rate cases according to
18 the Commission's Regulations.

19 Q How would that impact, then, this proceeding?
20 Let's assume we have got the general--we've
21 got the plan in operation.

22 A Okay.

23 Q Then, are you saying at that point that non-
24 recurring charges would not be brought up in any

1 of these alternative--
2 A Wouldn't be anticipated, no. This is a
3 mechanism that is sort of like--this may not
4 be a perfect analogy, but like the GSCs non-
5 recurring charges don't come up in that. It
6 is a mechanism that operates with respect to
7 the formula that is set forth in the rate.
8 Other issues that you are trying to
9 accomplish wouldn't be envisioned, the
10 mechanism is what would be the focus of the
11 review, not these other issues. These other
12 issues would be dealt with at a later time
13 perhaps in the three year review.

14 CHAIRMAN HELTON:

15 Mr. Seelye, if you modeled this after
16 existing tariffs in Kentucky, and you
17 have mentioned environmental surcharge
18 and GCR adjustment, those things are
19 done on a--we have a six month review on
20 FAC and environmental surcharge, then we
21 have annual reviews and then we have two
22 year reviews.

23 A Uh-huh.

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CHAIRMAN HELTON:

Particularly because in the first year it is going to be based on the proposed budget that is passed by the Board of Directors. Was there any consideration given to a review in the first six months, the next--for the first period that this would be in effect?

A No, we did not consider that. I mentioned a lot of tariffs, a comment about those two that you mentioned, those reviews are defined by statute. Okay. That is a little different than what we are dealing with here. Probably a better analogy is the GSCs or GCRs of various utilities. In fact, this--our proposal was modeled very closely after the GSCs and those are mechanisms that came out of orders, rate cases, orders--rate cases, as a matter of fact, the GCR and GSCs did. Therefore, they are much more similar to what we are dealing with here.

Q During the annual reviews I take it that the Commission will have the opportunity to review costs; is that correct?

1 A Yes.

2 Q Should any adjustments to disallow the cost
3 need to be made, should they be made in
4 the calculation of the AAC or the AAF?

5 A They could be done in either or both.

6 Q Would the adjustment be more favorable to
7 ratepayers if it is made in the AAC and the
8 company does not collect the associated
9 revenues and then refund them through the
10 AAF?

11 A I don't think that would be a major
12 consideration because the AAF provides a
13 true-up mechanism to bring the rate of return
14 within the range. There may be a small
15 timing difference but the nice thing about
16 the AAF calculation, it does provide a true-
17 up that brings the utility's rate of return
18 within the range authorized by the
19 Commission.

20 Q Then most of these adjustments would normally
21 be made as part of the AAC component?

22 A They could be, yes. As far as specific--for
23 example, if a type of cost that is--has been
24 eliminated in a rate case, this rate case, for

1 example, that would be take care of in the AAC
2 calculation to elaborate on that a little bit.
3 That would be the first component, therefore,
4 those types of costs would be eliminated.

5 Q So, you are saying that all expenses that the
6 Commission has disallowed in the most recent
7 rate case or in the most recent three year
8 review would automatically be removed from
9 the calculations?

10 A Yes.

11 Q How do you proceed to do that? I assume the
12 utility is still going to be budgeting, then,
13 even if they are not retaining--recovering
14 them for rate making purposes?

15 A Yes, we will have to identify them and not
16 include those in the budget. We are going to
17 have to make a specific identification of
18 those costs and remove those from the
19 methodology that is used to come up with
20 cost.

21 Q Would that, then, require something similar to the
22 work sheets that are in the Alagasco tariff where
23 certain expenses are--

24 A We envision just like--just like in the

1 application of the GSCs in Kentucky. We
2 provide cost support or detail enough where
3 you can see what is going on. We would
4 envision that same type of filing here, and
5 enough detail--and, again, that could evolve
6 to some extent, but we would envision enough
7 detail where you will be able to see the
8 approach that is used.

9 Q To the extent that a new expense arises, is
10 that one that is going to be subject to
11 consideration during the annual review?

12 A Yes, that would be. Let's draw another
13 analogy in explaining that to the GSCs that
14 are filed. Whenever there are costs that
15 come up with respect to gas supply costs,
16 frequently, I can remember administering that
17 at LG&E for a number of years and every two
18 or three filings there would be a new gas
19 supply costs that would have to be identified
20 and explained. And I would envision enough
21 explanation on specific cost items would be
22 identified.

23 Q How do you find those items? I mean, it
24 sounds almost as if the budget that is

1 submitted is going to have to be in extreme
2 detail in order for the Commission and staff
3 and any intervening party to go ahead and go
4 through it.

5 A The--what we are talking about here is not
6 normal expenses in the course of operating
7 your business. What we would be talking
8 about is new or extraordinary items that
9 would have to be identified. For example, if
10 there--I can't give you a good example on--
11 because I don't know what the future holds,
12 as far as for this particular mechanism, but
13 let's say that there is a major or an expense
14 that is incurred to do something different
15 than they have done before in terms of
16 operating their business. Then that would
17 be--should be explained and the Commission
18 should be alerted to it, to that fact just
19 like you are in the application of GSCs.

20 Q Will the--in administering the plan, will the
21 Commission, I guess by implication, and staff
22 have to become more familiar, perhaps
23 intimately familiar with the operations of
24 Delta in order to properly administer it?

1 A I believe plans like this do result in the
2 staff becoming more familiar with the
3 utility's operations. Okay. To give you an
4 example, I keep coming back to the GSC, but I
5 think that is a good--

6 Q Well, if I can--and I don't mean to
7 interrupt, but can you give us a example
8 based upon your conversations with Mr. Reed
9 from Alabama?

10 A Okay. Yes, I can. They do regular reviews
11 of the filing, they have regular telephone
12 calls. When the discussion yesterday, you
13 said maybe you--somebody at the staff has
14 spoken with them, you--the assumption was
15 that there was a monthly review. Okay. My
16 discussions with Mr. Reed is that they have--
17 they do monitor it regularly on a monthly
18 basis, they monitor their cost. They call
19 and ask questions about what is in these
20 costs on a regular basis. Okay. They also--
21 they go visit the utility and perform audits
22 in a manner that is similar to the audits of,
23 for example, electric utility's fuel
24 adjustment clause, the Commission performed

1 regular audits of the Fuel Adjustment Clause
2 and in that process the staff becomes much
3 more aware and attuned to what is going on
4 with the utility's operations. I don't think
5 that is a bad thing either. I think that
6 the--if the staff understands more they are
7 in a better--a more informed position to
8 understand what is going on with the
9 utility's operations.

10 Q To the extent that you have got--you have
11 viewed this as a collaborative process. I
12 assume that, not only will the staff, but
13 also the Attorney General or whoever is
14 representing the consumer interest would also
15 have to come up to that same degree of
16 familiarity?

17 A That's up to them, really. And to give you a
18 example, the GSC, there is never--I was
19 never--they would have the opportunity to do
20 that, I'm sure, they could have monitored
21 LG&E's cost but they didn't do that, and this
22 is not a criticism of the AG's office. They
23 have the same sort of constraints that any
24 administrative agency would have or whatever

1 the correct characterization--however you
2 correctly characterize your department. But
3 that is entire--I think that is entirely up
4 to the AG's office.

5 Q Well, let me--you are familiar with the two
6 avenues that are currently available for
7 utilities to file for rate adjustments, not--
8 a utility can file an adjustment based on a
9 historical test year or file one based on a
10 future test year?

11 A Yes, sir.

12 Q And would you agree that the filing in the
13 future test year is significantly more
14 burdensome and more complex to deal with?

15 A Yes.

16 Q And is that in part because you are dealing
17 with future events and so the basis for the
18 estimations are--come under greater scrutiny?

19 A Yes.

20 Q Okay. To the extent that Delta would be
21 using a budgeted test period, or budgeted
22 year, would you have the same problems there
23 as you would have for a forecast test year?

24 A You wouldn't necessarily have to have the

1 same--it depends on how comfortable everybody
2 gets with it. But it could--forecasts are
3 definitely more--they don't have the level of
4 accuracy that you have with respect to actual
5 cost. There is no question about that
6 because there is--you are trying to predict
7 the future and you don't know exactly what
8 that will--what will happen there, but the
9 mechanism we propose does have an AAF
10 component that will bring you back after the
11 first year to the--to actual cost.

12 Therefore, it is a one year exposure here,
13 unlike a rate case, which is not limited to
14 one year, that you are not in a--with respect
15 to a forecasted test year you don't true-up
16 actual results after it is implemented.

17 Therefore, there is a major difference
18 between what we are proposing here and the
19 forecasted test year, which is permanent,
20 because you do true it up in this mechanism.

21 Q Well, it is permanent only to the extent that
22 the next rate case is filed, is that correct?

23 A Well, it could be permanent if they keep
24 filing forecasted test years, it could be

1 permanent forever. You could always look at
2 a forecasted test year. Therefore, I see
3 that there would be more of a reason for much
4 more scrutiny in a forecasted test year than
5 what we are talking about here.

6 Q In response to the Commission's order of June 4 in
7 the 99-046 case, you state that the proposed
8 mechanism is designed to improve operational and
9 financial performance. What is the financial harm
10 that you refer to that could result from earnings
11 variability?

12 A Okay. The--I can give you a very real
13 example. If earnings variability--if you
14 have a number of years of abnormally mild
15 weather, for example, the earnings of the
16 utility can be impacted by that. It can--the
17 results that we have see in Delta's case is a
18 reduction in the equity component not being
19 able to earn its dividends four out of the
20 five past years plus, like I said, a negative
21 retained earnings which drives down the
22 equity percentage in its capital structure.
23 Therefore, variability has a direct impact on
24 the utility's financial performance in that

1 situation. And driving down--the poor
2 performance also has the--makes it much more
3 difficult for the utility to raise equity
4 capital to bring its capital structure back
5 in line, because the investment community
6 doesn't--you can't find anybody to,
7 basically, take your shares, therefore, it
8 makes it much more difficult for the utility
9 to maintain its financial integrity in
10 situations such as that.

11 Q Is there any other provision in the proposed
12 plan other than the purported reduced
13 regulatory cost that would result in savings
14 that could be captured and shared with
15 customers as would normally be done in a
16 performance base rate plan?

17 A Well, I assume by your questions that you are
18 referring to the filing prior to the
19 inclusion of the performance based measure.
20 Okay. With the inclusions of additional
21 performance based measures there is a big
22 benefit if the company can take measures to
23 improve its performance with respect to
24 operation and maintenance expenses, the

1 customers realize a benefit from that.

2 Q Delta has proposed, in part, that it be given
3 the option to discontinue the adjustments if
4 it would result in a non-competitive price.
5 Can you tell us how that would work?

6 A That would--I would see that working or that
7 would work as a part of the annual filing.
8 And this is not some hypothetical situation
9 either, because the situation could arise
10 with respect to competition in the electric
11 business where Delta does not feel that it
12 can increase its prices and remain
13 competitive with electric heating. And in
14 Kentucky, as we are aware, there is very low
15 electric rates, therefore, Delta faces
16 competitive pressures that a lot of gas
17 companies in the rest of the company doesn't
18 face. And what you would--what Delta would
19 do is to not increase the AAC component or
20 perhaps even the AAF component of its rates
21 and, therefore, it would establish a lower
22 AAF, AAC component. The way I would see that
23 working is it would establish a lower AAC
24 component or an AAF cost component and I

1 don't see it working or affecting the balance
2 adjustment, is what I'm driving at there.

3 Q Well, I guess I'm looking at it from the
4 pointy-headed bureaucrat outlook which is,
5 first of all, as I understand it, we are
6 going to have the annual review, and after
7 the annual review has been completed, then
8 Delta will elect or make some determination
9 as to whether its rates are going to be non-
10 competitive?

11 A No, I would see it not after the annual
12 review, but as a part of a filing itself.

13 Q And how or what guidelines are going to be
14 used to determine whether a rate is
15 uncompetitive?

16 A Okay. The guidelines will--I don't think
17 that there is going to necessarily be rigid
18 guidelines. This is a voluntary reduction
19 that the company sees that it needs in order
20 to remain competitive. They will--if they
21 find themselves in a position of not being
22 able to be competitive, then they will
23 voluntarily reduce the AAC amount or--and/or
24 the AAF amount in order to keep the costs

1 down, to keep the rates from going up.

2 Q In your response to, I think it is Item 23,
3 you talk about the--conducting a competitive
4 assessment.

5 A Uh-huh.

6 Q What exactly is that?

7 A A competitive assessment is an analysis that
8 looks at what prices are necessary to remain
9 competitive. It is more complex,
10 unfortunately, than just looking at a single
11 price point. The--you have to look at cost
12 regionally and before Delta would take the
13 step of not increasing its rates, it would be
14 my suggestion that they take a hard look at
15 the marketing impacts that the rate reduction
16 would have in order to try to evaluate the
17 effect of the rate suppression, if you will,
18 as far as how will it truly make you more
19 competitive with electric energy, which is
20 probably the one that we would be talking
21 about here. It could be propane as well.

22 Q Okay. When you are making your assessment
23 are you going to be looking at what has
24 already occurred? And by that I mean are you

1 going to be looking at the fact that Delta
2 may have lost customers during the preceding
3 period and determine that it cannot raise
4 them or are you looking at what the impacts
5 would be from making the adjustments that
6 have been required under the formula?

7 A I think you would look at both, probably, the
8 former one as far as--your losing customers
9 will precipitate the need to look at--take a
10 hard look at the impact that your rate is
11 having on your marketing efforts.

12 Q Okay. Let's assume for the moment you have
13 such a situation, is this election not to
14 have the formula carried out, is that going
15 to be a temporary suspension of the plan or
16 is it at that point is it--once Delta elects
17 to do that, is it opting out of a plan
18 totally?

19 A Oh, no. It is modifying the amount that it
20 would include in the AAC amount that they are
21 filing. In other words, they make these
22 annual filings, they would, as a result of
23 their competitive assessment, they would
24 reduce--the plan could still go on, they

1 would just reduce the amount of--the AAC
2 amount that is used in the calculation and
3 that would be tracked on through for the next
4 couple of years while that is tracked
5 through.

6 Q And I take it that there would be no type of
7 balancing account in effect to allow Delta to
8 recover that at a later point?

9 A No, that would be--the way I see that would
10 work is the AAC--let me--if it is done
11 through the AAF, what you just described is
12 true. If it is done through the AAC, which
13 is the first component, there could still be
14 a later true-up mechanism to take care of it.
15 So, it depends on the two paths that the
16 utility could take. For example, it may be
17 necessary, they may feel it is necessary to
18 take it out of the AAC--AAF amount which is
19 the second component, that would be lost.
20 That would--there would be no post recovery
21 of that. If it is in the AAC there could be
22 post recovery, so it depends on which path
23 that the utility takes in that regard.

24 Q Let me take that point one step further and I'll

1 try to close up. If I understand you right, with
2 the opt out provision, essentially, what the
3 utility is saying it's going to forego its earning
4 within the authorized range provided by the plan
5 because of competitive pressures; is that correct?

6 A Okay. Let's make sure that we are correct in
7 the terminology that we use, okay, because
8 there is two different opt out types of
9 things that we are talking about. Okay, the
10 first one was--

11 Q Okay. When I say opt out, I'm talking about
12 the temporary foregoing of additional rates
13 produced by the annual adjustment.

14 A Okay. I wouldn't use the word opt out for
15 that. Okay? It is a voluntary reduction in
16 the level of the charge, okay. Now, what is
17 the question again, please, I lost the
18 question.

19 Q If Delta were to decide because of
20 competitive pressures that it is going to
21 forego the annual or the increase in rates--

22 A Yes.

23 Q --required by the annual adjustment, doesn't
24 it, in effect, begin to earn less--its

1 management has made the decision to earn less
2 than the authorized rate of return?

3 A Yes, sir.

4 Q Okay. Will that not put you, in some
5 respects, in the same position that you are
6 now?

7 A Unfortunately, it may very well, but that is
8 competitive pressures.

9 Q Well, doesn't that then come back to the
10 whole--that the problem may not so much be
11 the regulatory procedures as it is the market
12 itself?

13 A In that situation, that is correct, but
14 that's, unfortunately, a reality of the
15 natural gas business.

16 Q Well, let me follow up on that because I
17 think that was one of the benefits you had
18 said would come from this plan, that it will
19 make Delta more competitive. But if it is
20 already facing competition and as a result of
21 competition it would have to suspend the
22 plan, doesn't competition already serve to
23 make it more competitive? Or let me put it
24 another way, if it looks at its budgeted

1 costs and sees that it has got to cut them
2 down, it is going to cut them down every way
3 it can but still remain in compliance with
4 its lawful requirements?

5 A Yes, and I believe that is true. I think it
6 is also true that this sort of mechanism,
7 probably, for that very reason and because of
8 the competitive pressures that nature gas
9 businesses face, very appropriate for natural
10 gas businesses. Natural gas, probably, faces
11 more competitive pressures than the electric
12 business, for example. Because natural gas--
13 there are substitutes for basic--almost
14 everything that natural gas is used for.
15 Unlike electric energy there is no viable
16 substitute for lights, for example. I mean,
17 I guess you could have gas burning lights,
18 but you don't see those. Okay. There is not
19 viable alternatives for this machine that is
20 setting here. Therefore, natural gas, there
21 are viable alternatives for that. Okay,
22 therefore, there are going to be pressures in
23 the natural gas business that will act as a--
24 as a moderation, if you will, that is a

1 performance based measure that is very real,
2 that exists for natural gas businesses.

3 Q So, in the case we just talked about, because
4 of those competitive pressures, the only
5 option the company would have would be to cut
6 its cost or find some new way to market its
7 product?

8 A Exactly.

9 Q On the Alagasco plan, I had a 5% cap on
10 annual revenue--had a 4% cap on annual
11 revenue increases. Delta has chosen a 5%
12 increase as the cap. How did you all arrive
13 at the 5% figure?

14 A That was somewhat of a subjective
15 determination. It was based upon what we see
16 out of CAPN contracts. We see 5% more--I
17 have signed certain contracts over the year
18 that have 5% caps, it is just something I see
19 more so and it sounds more reasonable than a
20 4% cap.

21 Q Do you know how Alabama Gas Corporation
22 determined or how the Alabama Commission came
23 up with a 4% cap?

24 A No, it was in place--this mechanism has been

1 in place a long time. I don't know how they
2 came up with that cap.

3 Q So, you don't know if that method was any
4 less subjective or more objective than the
5 method you all use?

6 A I suspect both of them had the same level of
7 subjectivity to it.

8 Q Just one more question and that relates to,
9 again, the issue of adversarial proceedings.
10 You had mentioned before that these annual
11 proceedings would be less adversarial and you
12 cited as an example, I think, the
13 Environmental Recovery Clause proceedings and
14 the Fuel Adjustment Clause proceedings.
15 Should I take it from your remarks that you
16 think the Commission's Fuel Adjustment Clause
17 proceedings have been pretty peaceful in the
18 last few years?

19 A Well, I haven't been here in the last few
20 years on the fuel adjustment hearings. When
21 I have--I was involved with fuel adjustment
22 cause hearings for a great number of years
23 and they were not nearly as adversarial as
24 the case we are in right now, and they were

1 not adversarial at all. I can't speak to
2 what has happened since.

3 MR. WUETCHER:

4 Okay. That's all we have, thank you.

5 CHAIRMAN HELTON:

6 We'll take a break.

7 (OFF THE RECORD)

8 CHAIRMAN HELTON:

9 Mr. Watt, any redirect?

10 MR. WATT:

11 Just very briefly, Your Honor, thank you.

12

13 REDIRECT EXAMINATION

14 BY MR. WATT:

15 Q Steve, when Ms. Blackford was questioning you
16 yesterday with her cross of Exhibit 8, which
17 contains Delta's response to Data Request Number
18 6, or some request, I can't remember which, there
19 was a discussion about how Delta's Alternative
20 Regulation Plan determines the AAC by the use of
21 budgeted costs. Do you recall that testimony?

22 A Yes, sir.

23 Q On pages 49 and 50 of your rebuttal testimony
24 and in Exhibit 5 to your rebuttal testimony,

1 it appears that you have proposed an
2 alternative method of calculating the AAC; is
3 that correct?

4 A Yes.

5 Q Would you please explain that to the
6 Commission?

7 A Okay. The purpose of the inclusion of that
8 tariff sheet was just simply to address the
9 concerns that were raised by the Attorney
10 General and concerns that I perceived were
11 raised in data requests. The--it did not
12 represent what we are recommending or filing
13 in this case. It represents an alternative
14 that--alternatives that could--that are
15 acceptable and, in one case, probably
16 appropriate. In the case of the
17 modification--one of the modifications was to
18 base the AAC calculation on actual cost as
19 opposed to budgeted cost. There was a
20 concern expressed by the AG's witness, Mr.
21 Henkes, about perhaps gaming the system. I
22 don't believe that possibility exists nearly
23 as strongly as Mr. Henkes claims. But if
24 there is any concern on the part of the

1 Commission, the alternative is to base--
2 instead of using actual, excuse me, instead
3 of using budgeted operation and maintenance
4 expenses that go in to calculate the return
5 on equity, budgeted return on equity, you
6 could use actual historical cost, actual
7 historical earnings in order to calculate
8 that. The other modification concerned the
9 use of the hypothetical capital structure.
10 This was precipitated by a question, a series
11 of questions, actually, in the Commission's
12 Data Request where the question was raised
13 about the appropriateness of using a
14 hypothetical capital structure and the
15 mechanism that, if the Commission allowed the
16 hypothetical capital structure, that the
17 mechanism as written would, basically, undo
18 that. And we responded to that in data
19 requests, if the Commission does indeed
20 accept the hypothetical capital structure, as
21 we believe that they should, or you should,
22 then this mechanism would go in hand with
23 that as suggested by the Commission staff's
24 data request.

- 1 Q Thank you. Just a moment ago you were discussing
2 the provision in the Alternative Regulation Plan
3 by which Delta, because of competition, would have
4 the right, in essence, not to increase its rates
5 as much as the Alt Reg Plan might determine they
6 should be. Is it true that Delta simply wants the
7 flexibility to reduce those rates and not
8 necessarily the requirement, that this is just a
9 management option to react to the competition?
- 10 A Yes, that is correct. This would just be a
11 management option.
- 12 Q Delta's Alternative Regulation Plan does not
13 require a three year review, does it?
- 14 A No.
- 15 Q The review that the Commission may want to
16 make of the status of Delta's operations and
17 finances could be upon any term the
18 Commission decides; isn't that the case?
- 19 A Yes, we have stated that in the data request that
20 we were talking about earlier, yes.
- 21 Q There was some discussion earlier today about
22 what might happen at the expiration of the
23 three year experimental period or at the end
24 of whatever the review period might be, and

1 there was some discussions that perhaps a
2 rate cause would occur. Is a rate case
3 necessary?

4 A Not necessarily, no.

5 Q Steve, isn't it true that if the Alternative
6 Regulation Plan proposed by Delta is filed,
7 that most of the underlying data that is
8 required to be filed in a rate case will
9 already have been filed pursuant to the Alt
10 Reg Plan and will have already been reviewed
11 by the PSC?

12 A Yes, the filing requirements that are set
13 forth in the tariff sheets are quite
14 extensive and there will be quite a lot of
15 cost information, so the answer to the
16 question is yes.

17 MR. WATT:

18 That's all I have, Your Honor.

19

20 RE CROSS EXAMINATION

21 BY MS. BLACKFORD:

22 Q I want to take up a little bit on the discussion
23 concerning the election, perhaps, on the
24 competition element not to increase rates. You

1 pointed out that it could be done either under the
2 AAC or the AAF and rightfully pointed out that if
3 it is done under the AAC and then subsequently be
4 recaptured through the AAF. I want to know
5 whether this election can be made with reference
6 to the AAC as it applies to a given class or
7 whether once the election is made it must apply
8 across the board?

9 A The way that the mechanism works it would
10 apply across the board. However, if I could
11 add a little bit more.

12 Q Sure.

13 A And I can't envision this situation arising, I
14 think that Delta would--should not be precluded
15 from making a specific consideration if the
16 situation warrants it, but that is certainly not
17 contemplated, was not contemplated in what we have
18 described. You raise a question that is an
19 interesting question.

20 Q Next question, would it be possible through
21 the interim ability to redesign rates, an
22 interim ability that I gather from the
23 discussion with Mr. Wuetcher, the utility
24 will continue to exercise, whether you could

1 not then adapt, as it were, the amount of
2 class recovery that is happening from each
3 class and, thereby, essentially, affect the
4 rates that each class is paying and
5 particularly in connection with a reduction
6 in--for competition purposes, then insure
7 that one class gets the better benefit of it
8 over another?

9 A That could happen, that is not what we
10 contemplate, though, or would contemplate.

11 Q I want to take up very briefly our friend,
12 Mr. Bonbright, again, as you mentioned
13 yesterday when we were talking about customer
14 costs in connection with the fully embedded
15 cost of service study. There was, in fact, a
16 discussion of a minimum system but none of
17 zero intercept, correct?

18 A In the--what I--to state what I said, I've
19 looked in the index and did not find zero
20 intercept in the index.

21 Q Well, let me bring you the updated version of
22 the holy writ. What I have here is the 1991
23 version, 1992 version, Principles of Utility
24 Rate Making which is Bonbright, Danielsen and

1 Kamerschen, let me pass this by you for the
2 spelling. I'm going to again refer you to
3 the fully distributed cost chapter which in
4 this version is Chapter 19, beginning on page
5 478, the customer cost provision section
6 begins on page 490. I'm referring you to
7 page 491 and if you would please read for me
8 this paragraph that begins with "The FERC"
9 and go through the first sentence of the next
10 paragraph.

11 A "The FERC Handbook recognizes that while
12 there are no hard-and-fast rules for
13 allocating customer costs, as they depend on
14 the type of costs involved, the issue is not
15 usually litigated as the dollars involved are
16 usually not substantial. The really
17 controversial aspect of customer-cost
18 imputation arises because of the cost
19 analyst's frequent practice of including, not
20 just those costs that can be definitely
21 earmarked as incurred for the benefit of
22 specific customers, but also a substantial
23 fraction of the annual maintenance and
24 capital costs of the secondary (low voltage)

1 distribution system--a fraction equal to the
2 estimated annual costs of a hypothetical
3 system of minimum capacity. This minimum
4 capacity is sometimes determined by the
5 smallest sizes of conductors deemed adequate
6 to maintain voltage while keeping them from
7 falling of their own weight. In any case,
8 the annual costs of this phantom, minimum-
9 sized distribution system are treated as
10 customer costs and are deducted from the
11 annual costs of the existing system, only the
12 balance being included among those demand-
13 related costs to be mentioned in the follow
14 section. Their inclusion among the customer
15 cost is defended on the ground that, since
16 they vary directly with the area of the
17 distribution system (or else with the lengths
18 of the distribution lines, depending on the
19 type of distribution system), they therefore
20 vary directly with the number of customers.
21 Alternatively, they are calculated by the
22 'zero-intercept' method whereby regression
23 equations are run relating to various sizes
24 of equipment and eventually solving for the

1 cost of the zero-sized system."

2 Q Thank you. Did you read that last sentence,
3 "What this last named cost computation
4 overlooks, of course, is the very weak
5 correlation between the area (or the mileage)
6 of a distribution system and the number of
7 customers served by the system."

8 A I can't recall.

9 Q All right. Well, having read it into the
10 record myself, now. So, the zero intercept
11 method is now addressed by Bonbright in
12 customer costs. I just wanted to point that
13 out to you. Thank you, I have no more
14 questions.

15 CHAIRMAN HELTON:

16 Mr. Wuetcher?

17 MR. WUETCHER:

18 Just a couple.

19

20 RE CROSS EXAMINATION

21 BY MR. WUETCHER:

22 Q Just out of curiosity, how long has Dr. Bonbright
23 been dead?

24 A I'm not sure exactly. I'm not sure.

1 VICE CHAIRMAN HOLMES:

2 Do you have a book, too?

3 A If you notice, just to elaborate on that a
4 little bit, there are other authors on the
5 title of the book.

6 Q I understand, it is just that we have been
7 talking about him so much I thought he may
8 have made a miraculous appearance.

9 A Now, this holy writ could be considered
10 apocryphal now.

11 CHAIRMAN HELTON:

12 He was a child prodigy and started
13 writing when he was seven, Jerry.

14 A Because we have other authors involved in it, it
15 is not the original thing.

16 Q I just want to follow up on two points. Mr.
17 Watt in his direct examination stated--or
18 asked you whether the materials that would be
19 supplied under the alternative rate making
20 mechanism plan as set forth in the tariff
21 would be the ones that you would normally be
22 filing anyway as part of a rate case.

23 A Yes, many of the documents would be.

24 Q Okay. I just want to make sure that--for

1 purposes of comparison, I'll leave it at
2 that. The materials that would be supplied
3 would be found at sheet 35 of the proposed
4 tariff, is that correct?

5 A Yes, sir.

6 Q Okay. And would it be correct to say that
7 the requirements that the utility would have
8 to file or set forth on pages--for a general
9 rate adjustment, are both set forth on pages
10 five and six of the utility's application for
11 general rate adjustment?

12 A Yes, sir.

13 Q Okay. And would you agree with me that both
14 filing requirements look at little bit larger than
15 the ones that are set forth on page 35 of the
16 tariff?

17 A Yes, I would agree with that.

18 Q Okay. One other thing, the Alabama Commission had
19 required monthly reports, the current provision as
20 proposed by Delta would not have monthly reports;
21 is that correct?

22 A No, not as filed, no.

23 Q But Delta has no objection to filing monthly
24 reports or monthly statements?

1 A It's my understanding that--and I know this
2 to be true because I came over and reviewed
3 all of the gas utilities in the state. They
4 file monthly operating reports with the
5 Commission already. And I would guess that
6 in Alagasco's case the reporting requirements
7 probably did not exist, or what they filed
8 with the Commission probably didn't exist
9 like it does in Kentucky.

10 Q And just for purposes of clarifying the
11 record, how many customers does Alagasco
12 currently have?

13 A I can't remember, but there are quite a lot.

14 Q Could you give us a ball park figure, we are
15 not going to hold you to it, except to the
16 extent for purposes of comparison to Delta's
17 customer base?

18 A I would say 15 times the number of Delta's
19 customers would be my guess.

20 MR. WUETCHER:

21 Okay, thank you.

22 CHAIRMAN HELTON:

23 Mr. Gillis?

24

1 COMMISSIONER GILLIS:

2 No questions.

3 CHAIRMAN HELTON:

4 Mr. Holmes?

5 VICE CHAIRMAN HOLMES:

6 No questions.

7 CHAIRMAN HELTON:

8 You may be excused. Mr. Watt?

9 MR. WATT:

10 Randall Walker.

11 (WITNESS DULY SWORN)

12

13 The witness, RANDALL J. WALKER, having first been
14 duly sworn, testified as follows:

15 DIRECT EXAMINATION

16 BY MR. WATT:

17 Q Randall, would you please state your name for the
18 record?

19 A Randall J. Walker.

20 Q Where do you live?

21 A I live at 1218 Park Avenue, Shepherdsville,
22 Kentucky.

23 Q By whom are you employed?

24 A The Prime Group, their address is 6711 Fallen

1 Leaf, Louisville, Kentucky 40241.

2 Q What is the purpose of your testimony in this
3 proceeding?

4 A My testimony in this proceeding has, basically,
5 three purposes. One purpose is to--I support the
6 pro forma adjustments that were made to the rate
7 case with respect to the revenues, such as the
8 elimination of the GCR revenues, temperature
9 normalization, year end adjustment. Another
10 responsibility I have in this rate case was the
11 apportionment of the revenue increase to the rate
12 classes and, in that regard, we were trying to
13 achieve some movement towards a better balance in
14 the class rates of return because there was quite
15 a difference between the classes, and at the same
16 time recognizing that customer acceptance and the
17 need to maintain rate stability by avoiding overly
18 disruptive changes in the rates and marketplace
19 realities had to be recognized as we do that, as
20 well as the pricing and the rate design itself.

21 Q Have you filed direct testimony in this case?

22 A Yes, I have.

23 Q Are there any changes, corrections or additions to
24 that testimony?

1 A Yes, I have one correction. On page eight of
2 my direct testimony, line four, this relates
3 to the year end adjustment, the number--the
4 "304,119" needs to be changed to"\$423,668,"
5 and on line 11 of that same page the
6 "\$54,487" which are the corresponding
7 adjustment to expenses for the year end need
8 to be increased to "75,906." We acknowledge
9 this was incorrect in our response to the
10 Attorney General's August 11 Data Request,
11 Item Number 73, and with that I also filed a
12 revised exhibit, Walker 5.

13 Q Subject to that correction, if I asked you
14 the questions contained in your direct
15 testimony today, would you give the same
16 answers?

17 A Yes, I would.

18 Q You have not filed any rebuttal testimony in
19 this case?

20 A No, I have not.

21 MR. WATT:

22 We have no further questions Your Honor.

23 We would move the admission of Mr.

24 Walker's testimony.

1 CHAIRMAN HELTON:

2 So ordered. Ms. Blackford?

3

4

CROSS EXAMINATION

5 BY MS. BLACKFORD:

6 Q Mr. Walker, let me refer you to page ten of your
7 testimony.

8 A Two?

9 Q Page ten.

10 A Ten, yes.

11 Q There, on the basis of Mr. Seelye's cost of
12 service study, you concluded that there is a
13 need to increase the rates to residential
14 customers more than there is a need to
15 increase the rates of other customer classes;
16 is that correct?

17 A Yes. That was pretty clear from that cost of
18 service study. The overall rate of return in
19 that--based on the actual rates adjusted for
20 the temperature and year end adjustments and
21 so forth, was 7.31%. The rates of return of
22 all of the other classes, other than
23 residential, exceeded even the proposed rate
24 of return after we included the rate

1 increase, residential was less than 4% and we
2 had some rate classes that were above 27%.

3 Q You concluded all of this on the basis of
4 that same cost of service study that the very
5 high earned rates of return for interruptible
6 customers, that because of those very high
7 earned rates for interruptible customers,
8 revenues should be reduced for the
9 interruptible class; is that correct?

10 A We--yes, we did. The interruptible class was
11 the class that had the return that exceeded
12 27% and if you turn to, I believe it is page
13 14 of Mr. Seelye's testimony, it basically
14 lays out in the first column what the actual
15 rates of return were by the rate classes and
16 what they are at the proposed rates, and this
17 change modestly reduced the rate of return on
18 the interruptible class from 27.37% to 25.52.

19 Q And then you would agree with the statement
20 that it is a reasonable use of a fully
21 allocated average embedded class cost of
22 service study to help determine, in part, how
23 any increase in revenues should be spread?

24 A Well, you use it as a guide, certainly.

1 Q Would it also be reasonable for a regulatory
2 authority with jurisdiction over rates to
3 determine that another type of--

4 A Excuse me--

5 Q --or another cost of service study--

6 CHAIRMAN HELTON:

7 Ms. Blackford, I don't think he can hear
8 you.

9 A Excuse me, I can't hear you. Can you--

10 Q Oh, I'm sorry. I'm so used to being the one
11 that can't hear I can't imagine that I can't
12 be heard.

13 A Well, that's two of us. Maybe we can shout
14 at each other.

15 Q Would it also be reasonable for a regulatory
16 authority with jurisdiction over rates to
17 determine that another cost of service study
18 which allocates rates would be--I'm sorry.
19 Would it be reasonable for a regulatory
20 authority to utilize another cost of service
21 study other than the one that you have
22 proposed to allocate rates?

23 A Well, I think the regulatory commission would
24 first have to determine whether that other

1 cost of service study were, in fact, more
2 appropriate.

3 Q And if it did so determine, it would then be
4 appropriate to allocate rates on that basis?

5 A Well, you, you know, you don't use the cost
6 of service study, generally in most cases, to
7 just go right down the line. The only place
8 that I'm familiar with that ever happening is
9 at the FERC, with respect to pipeline supply
10 rates, where it is--they basically build the
11 rates up from the cost of service study
12 rather than use the cost of service study as
13 a guide. They are just simply a guide to
14 look at what portion of the overall revenue
15 requirements and what portion of the earnings
16 each class contributes to the total, and
17 relative to one another, and you use those as
18 a guide and then moderate your proposed
19 changes in rates to try to take into account
20 the other things that I mentioned, such as
21 price stability and customer acceptance and
22 things of that nature.

23 MS. BLACKFORD:

24 Thank you. That's all my questions.

1 CHAIRMAN HELTON:

2 Mr. Wuetcher?

3 MR. WUETCHER:

4 Just a few.

5

6

CROSS EXAMINATION

7 BY MR. WUETCHER:

8 Q At page 13, line six of your testimony, you state
9 that all residential volumes fall within the first
10 200 MCF block. If all residential customers fall
11 within this block, why isn't a flat rate more
12 appropriate for residential class than the present
13 declining block rate?

14 A Well, in fact, the current rate for
15 residential is a flat rate. It is a customer
16 charge and whatever is in the first block
17 because all their usage falls in the first
18 block and they don't have any usage in the
19 second, third and fourth blocks, so,
20 effectively, it is a flat rate.

21 Q Why is it appropriate to adjust for weather
22 normalization the bill for every customer
23 within a class, regardless of a customer's
24 usage?

1 A I'm sorry, I--

2 Q Let me try that again. Why is it
3 appropriate to adjust for weather
4 normalization every customer's bill within a
5 class regardless of the customer's usage?

6 A Are you referring to a weather normalization
7 clause?

8 Q Yes.

9 A Is that what you--you are not talking about
10 the weather normalization that I did for the
11 rate case, you are talking about the weather
12 normalization clause that the company filed;
13 is that what you are--

14 Q Yes, sir.

15 A Oh, okay. Well, basically, the weather
16 normalization, what you are trying to do is
17 look at the departure that you have in a
18 given month for abnormal degree days, whether
19 they be more than normal or whether they are
20 less than normal and try to--and then to try
21 to bring that billing of your base rates back
22 to what the level would have been if you
23 would have had normal temperatures. Some
24 months you will take it down, some months you

1 will take it up. And that is one way to
2 spread it is over usage, I mean, you know, I
3 don't--as far as I know, most of them are
4 spread over usage. They are applied to usage
5 rather than to revenue or something like
6 that.

7 Q That leads me to my next question, what other
8 gas utilities use this method?

9 A In Kentucky?

10 Q Yes, sir.

11 A The only other--well, I'm not sure if there are
12 any in Kentucky, maybe Columbia has one or had
13 one, but I wasn't sure in Kentucky that anyone had
14 a weather normalization clause.

15 Q Okay. Let's then expand our geographical
16 range, what other utilities are you familiar
17 with that also have--

18 A Well, I know Columbia has weather
19 normalization clause in a number of their
20 other jurisdictions, other states, because
21 when I was at LG&E I had contact with the
22 Columbia people and I'm--that's the reason I
23 wasn't sure whether they had it in Kentucky
24 because there was some--were contemplating

1 doing so, and this was a good while ago. But
2 they have--I believe they had it in, if I'm
3 not mistaken, in Virginia and some of the
4 other states that they service. And, you
5 know, Alabama is a good one, we have one
6 there, I think, weather normalization clause.
7 They may even have one in Georgia, if I'm not
8 mistaken, but this is kind of hazy who has
9 one.

10 Q Okay. Why is it appropriate to use the norm--
11 30-year normal degree data for Lexington,
12 Kentucky, to determine the normal degree days
13 for Delta's proposed weather normalization
14 factor?

15 A Oh, I think you could use--you could probably
16 use any normal if you wanted to at any place
17 sort in the geographical region, because what
18 you are--you've got to remember what you are
19 doing with weather normalization clause. You
20 just really adjusting for the percentage
21 departure from normal and whether it is
22 Lexington, Kentucky, or London, Kentucky or
23 Frankfort, or whatever, the departures, the
24 percentage departure, and that's really what

1 you are getting down to, from normal, because
2 you are just basically taking the actual
3 degree days relative to the normal at that
4 particular location. I wouldn't think the
5 percentage departure should be much different
6 from one location to the other. Now, the
7 actual normals may be different but so will
8 the actual numbers. But the percentage
9 change is not going to be that much so,
10 therefore, you adjustment should be a great
11 deal different regardless of the temperature
12 station you use. As long as you stayed
13 within the reasonable geographical range.

14 MR. WUETCHER:

15 Thank you. That's all I have.

16 CHAIRMAN HELTON:

17 Redirect?

18 MR. WATT:

19 I have no further questions.

20 CHAIRMAN HELTON:

21 Thank you Mr. Walker. I think that concludes your
22 witnesses Mr. Watt?

23 MR. WATT:

24 That's all for us Your Honor.

1 CHAIRMAN HELTON:

2 Ms. Blackford?

3 MS. BLACKFORD:

4 Robert Henkes please?

5 (WITNESS DULY SWORN)

6

7 The witness, ROBERT J. HENKES, having first been
8 duly sworn, testified as follows:

9

DIRECT EXAMINATION

10 BY MS. BLACKFORD:

11 Q Mr. Henkes, would you state your name and business
12 address for the record please?

13 A Robert J. Henkes, 7 Sunset Road, Old
14 Greenwich, Connecticut 06870.

15 Q Are you the same Robert Henkes who filed
16 testimony in Case Number 99-046 on July 30 of
17 this year?

18 A Yes, I am.

19 Q Are there any corrections or additions that
20 you wish to make to that testimony?

21 A Not at this time.

22 Q Are you the same Robert J. Henkes who filed
23 testimony in connection with Case Number 99-176 on
24 the 23 of September of this year?

1 A Yes.

2 Q Are there any--are you also the same Robert
3 Henkes who then almost immediately filed an
4 errata sheet consisting of some, I think,
5 nine corrections?

6 A Yes.

7 Q Other than those corrections shown in the errata
8 sheet, are there any corrections or additions you
9 wish to make to this testimony?

10 A No, ma'am.

11 MS. BLACKFORD:

12 I move the testimony be admitted into
13 the record and pass the witness for
14 cross.

15 CHAIRMAN HELTON:

16 So ordered. Mr. Watt.

17 MR. WATT:

18 Thank you, Your Honor.

19

20 CROSS EXAMINATION

21 BY MR. WATT:

22 Q Good morning Mr. Henkes, how are you today?

23 A Good morning, I'm almost organized here.

24 Q Let me know when you are.

1 A I am.

2 Q You are?

3 A Yes.

4 Q Would you please refer to page ten of your
5 testimony in the rate case?

6 A Right.

7 Q I apologize, I don't have the line number but
8 you say on that page "generally a utility's
9 return requirement is determined by applying
10 the calculated overall rate of return to the
11 rate base investment, not the capital
12 structure amount," do you have that before
13 you?

14 A Yes.

15 Q And that is what you say, isn't it?

16 A Right.

17 Q In response to Delta's data request to the
18 Attorney General, Item 76, I believe you
19 identified two cases in Kentucky where rate base
20 rather than capital structure was utilized to
21 calculate return requirements; is that right?

22 A Yes, those were the two most recent
23 proceedings that I have been involved with,
24 namely, Delta's last rate case and the

- 1 Kentucky-American Water case.
- 2 Q Kentucky-American Case 97-034; is that right?
- 3 A Yes.
- 4 Q Isn't it true that Kentucky-American Water
5 Company is a wholly owned subsidiary of an
6 out of state corporation?
- 7 A Yes.
- 8 Q You are not aware of any other instances in
9 which the Kentucky PSC has utilized rate base
10 rather than capital structure, are you?
- 11 A I didn't research it, so I'm not aware of
12 that, no.
- 13 Q You--are you aware that the Kentucky PSC has
14 utilized the capital structure to determine
15 revenue requirements in Case Numbers 90-158,
16 10064, 8924, 8616, and 8284 all involving
17 LG&E?
- 18 A Subject to check, and, you know, I would
19 assume that those are all prior to the last
20 two cases that I mentioned.
- 21 Q You are also aware, speaking of prior cases,
22 that the Kentucky PSC used the capital
23 structure in Delta rate cases prior to 97-
24 066, aren't you?

- 1 A Yes, and I believe that policy has been changed
2 starting with the last case, maybe the AG put on
3 some testimony that threw some light on--some
4 additional light on it where it got convinced the
5 Commission that maybe that was the right way of
6 going.
- 7 Q Actually, what I was going to was the term
8 "generally" in your testimony. When you say
9 "generally" a utility's return requirement is
10 determined by applying the rate of return to rate
11 base, you really were only referring to two cases,
12 weren't you?
- 13 A No. I'm referring to every case that I've
14 been involved in in my 22 years of regulatory
15 experience. I am saying, generally, because
16 I was aware that this Commission in the past,
17 when I did three cases here, used the capital
18 structure. But I don't know of any other
19 jurisdictions where they use that method.
- 20 Q Would you please return to, excuse me, turn
21 to Delta Data Request, Item 80, your response
22 to it?
- 23 A I have that.
- 24 Q I believe in your response to that data

1 request you agreed that if the level--that
2 the level of Delta's employees will be
3 affected by the assumption that Delta's
4 customers would double; isn't that
5 essentially what you say there?

6 A Yes, I mean, more generally I'm saying that
7 in the long run every cost is variable, even
8 fixed costs become variable. I mean, if you
9 make an assumption that the system doubles, I
10 would assume that, you know, it is very
11 unrealistic to assume that it wouldn't have
12 any impact on the number of employees.

13 Q Would you also agree that smaller increases
14 in the number of customers will also affect
15 the employee level?

16 A It certainly hasn't been proven in this case.
17 We took Mr. Seelye through that--through the
18 cross-examination yesterday where it showed
19 that in the last ten years his company's
20 employees didn't change while its system grew
21 by 22%. And when you are looking at an
22 adjustment where you stay within the test
23 year, you are just adjusting for a year end
24 event versus an average event in the test

1 year. I don't think that you can assume that
2 the level of employees are going to change,
3 that there is a direct variability. There is
4 a direct variability in terms of gas
5 expenses, I would readily agree with that,
6 but certainly not in terms of property
7 insurance, or level of employees, or employee
8 benefits, and things of that nature.

9 Q Well, if customers increase, isn't it true
10 that Delta's employees, whether it is the
11 same ones or more employees, are going to
12 have more meters to read; isn't that a fair
13 statement?

14 A Yes.

15 Q And isn't it true that there are going to be
16 more bills rendered?

17 A Yes.

18 Q And its true that there is going to be more
19 meters tested; isn't it?

20 A Yes, and you still have the same employees
21 and it doesn't make any difference in your
22 expense, you are still paying the same
23 salary.

24 Q And it's true that there is going to be more

1 service calls; isn't that right?

2 A There might be some incremental expenses,
3 yes, and that is why we are giving effect to
4 that, I have said there should be a 4%
5 incremental expense rate. There is going to
6 be probably some additional maintenance
7 expenses, there might be some additional
8 uncollectible expenses. So, yes, there are
9 certain expenses that vary directly. I would
10 agree with that, but certainly not to the
11 extent of 18% of your revenues.

12 Q It's true that there is going to be other
13 tasks besides the ones that I just mentioned
14 that are going to have to be performed if the
15 customer count increases; isn't that right?

16 A Yes, I'm not going to argue that.

17 Q Would you please turn to Delta's Data Request
18 Number 79 to the Attorney General, your
19 response to it?

20 A Yes, I have it here.

21 Q In that response you identify, in the middle
22 paragraph of your response, a number of kinds
23 of expenses that you say do not vary with
24 incremental consumption resulting--do you see

1 that, do not vary with incremental
2 consumption? And those expenses are labor,
3 employee pension and benefit expense,
4 regulatory commission expense, property
5 insurance expenses, outside services and
6 miscellaneous general expenses?

7 A Yes.

8 Q Did I read those correctly?

9 A Yes.

10 Q Isn't it true that you have not performed any
11 studies which demonstrate that no incremental
12 costs are incurred by the utility,
13 irrespective of the number of customers added
14 to the system for those specific items that
15 you removed when you calculated your proposed
16 3.62% expense to revenue ratio?

17 A No, similar to what--I don't think the
18 company did a study, I certainly didn't do a
19 marginal cost study for this type of issue.
20 I looked at historical experience, I looked
21 at your level of employees, I looked at your
22 system growth and I guess I just used logic
23 and common sense, maybe that is the way to
24 abbreviate it.

1 Q Would you turn to Item 78, your response to
2 Item 78? Do you have that before you?

3 A Yes.

4 Q In that response you stated that you have not
5 performed a review of whether the Kentucky
6 Commission has recognized your expense to
7 revenue ratio methodology as superior to
8 Delta's methodology; correct?

9 A Right. I'm saying I haven't performed that
10 review. I wasn't aware that there--apparently,
11 the Commission in the past has used this as a
12 method and they must have because that is what you
13 used as the starting point. All I know is that I
14 propose a revenue annualization adjustment in the
15 last case and the Commission adopted that. In
16 fact, the company used that same method in this
17 case. I have taken this, maybe Commission
18 initiated expense to revenue method and with all
19 due respect improved it, in my opinion. I mean, I
20 would think that if the Commission believes that
21 labor expenses must be removed and I think,
22 logically speaking, it dictates that you remove
23 employee benefits and other employee related
24 expenses. And I don't think that insurance,

1 property insurance, is going to change or
2 regulatory commission expenses, things of that
3 nature.

4 Q Would you please turn to your rate case
5 testimony, pages 30 and 31, your testimony?

6 A Yeah, I know, I have it in various places.

7 Q Oh, I see, I apologize.

8 A Yes, I have it.

9 Q Okay. Just paraphrasing what you have done there,
10 you have recommended that Delta's bad debt expense
11 should be \$250,666.

12 A Are we talking about bad debt, not rate case
13 expenses?

14 Q Bad debt, yes.

15 A Oh, okay. Yes, I have recommended that.

16 Q Instead of the actual test year bad debt
17 expense of 345,870?

18 A Right.

19 Q I believe you recommended using a four year
20 average bad debt expense; isn't that right?

21 A Well, I think you ought to look at my
22 Schedule RJH-14. It will give you a little
23 perspective of what I did. I just want to
24 wait until you are there, are you there?

1 Q I'm where I want to be, you go ahead and
2 answer my question.

3 A I did look at the last six years, 1993
4 through 1998, because that is all the data
5 that were available to me, and I did an
6 analysis and I said, okay, it has been going
7 up from .36% of revenues to .99%. Now, you
8 can say, as Mr. Seelye said the other day,
9 yesterday, well, there is an increasing trend
10 and, therefore, you know, it should increase
11 after the test year. But I don't think that
12 is the way you ought to look at it. This is
13 an alarming trend and if you don't set a more
14 reasonable rate the company will not have an
15 incentive to try to do something, or to try
16 to continue to do what they are doing,
17 apparently, doing right now. There is a dire
18 response available that says that the company
19 is being--is enforcing its rules much more
20 stricter and more aggressively, bad debt
21 expenses have decreased. So, based on that,
22 I did indeed assume as a normalized rate the
23 average of the last four years and I've been
24 conservative in that. As you can see, I

1 threw out the first two years, those two low
2 numbers, the .36 and the .33. They were part
3 of the analysis, but I just out of
4 conservatism have thrown them out, and this
5 is how I got to the still very high level, I
6 think, of .67%.

7 Q So, it was a four year average?

8 A To make a long story short, I realize it is
9 too late for that but, yes, it was a four
10 year average.

11 Q Would you refer to your response to Delta's
12 Data Request Number 81?

13 A Yes, I am there.

14 Q Is my understanding correct that your
15 response to that data request item indicates
16 that you performed no studies of bad debt
17 expenses of companies similar to Delta?

18 A Did I say that?

19 Q That's what I thought you said, that's why
20 I'm asking you the question, just to make
21 sure you did.

22 A I say in any case that I'm involved I perform
23 a study. Now, I do--you see, there are not
24 many rate cases any more these days so the

1 last four that I did, five, are all--involve
2 water cases. But I can rattle them off for
3 you, they are the Artesian Water Case, and I
4 have all the docket numbers if you need them
5 that I just recently did and they had an
6 uncollectible rate of .30%.

7 Q Is Artesian the one that you took the pages
8 out of and submitted in response to the--

9 A Yes, yes.

10 Q --Commission's data request?

11 A Yes, that's right.

12 Q Okay, go ahead.

13 A As the Mt. Holly Water Case in New Jersey
14 that had a ratio of .15%, then there a large
15 company, New Jersey-American Water Company,
16 \$220,000,000 worth of revenues, they had a
17 ratio of .42%, Middlesex Water Company in New
18 Jersey is .17%, and United Water Delaware had
19 a ratio of .14%. So, there are a lot more
20 studies that I've done, but these are the
21 most recent five cases I've done in this last
22 year.

23 Q Rather than a study, though, what you are
24 saying here today is that you have

1 participated in four cases recently and these
2 are the numbers for those cases; correct?

3 A No, we actually studied them. I mean, it is
4 not like the companies--the numbers were
5 there and we just rubber stamped them and
6 said that is fine. We looked at them, we
7 studied them, we normalized them, and these
8 are the rates that were adopted by the
9 Commission.

10 Q I'm sorry, I didn't make myself clear in my
11 question. Rather than undertake a study of
12 bad debt expense for gas companies in a
13 particular geographic region or of a
14 particular size, your study of bad debt
15 expense amounts to telling us about four
16 water cases that you recently participated
17 in; is that right?

18 A Yes, that's right.

19 Q Okay. Is that your basis for using the four year
20 average bad debt expense in your adjustment?

21 A Because I used it for five other companies?

22 Q Yes.

23 A No.

24 Q Your proposed bad debt expense of 250,000

1 plus is approximately \$95,000 less than test
2 year bad debt expense; correct?

3 A Right.

4 Q And it is also approximately \$60,000 less
5 than bad debt expense for the year prior to
6 the test year; correct?

7 A Yes.

8 Q You know, I think you answered this question,
9 but let me make sure that I understand it.
10 The reason that you suggested this adjustment
11 was based on, I think, two things. Number
12 one, you said you wanted to provide an
13 incentive for Delta to do better on bad debt
14 expense and, second, there are some steps
15 being taken in which Delta anticipates doing
16 better and, therefore, the bad debt expense
17 for test year purposes ought not be as high
18 as the actuals; did I state your position
19 correctly?

20 A Yes, I'd rather say it in my own words, but--

21 Q I'd rather say it in my own words.

22 A Yeah, I know, I am saying that this involves
23 an expense that has an alarming trend where
24 we also know that now that the company itself

1 has found that it is getting out of hand and
2 apparently is taking some really aggressive
3 steps to work on it. It is not only my own
4 recognition, I think the company recognized
5 it. And for the purpose of setting rates for
6 this company, I just don't think that you can
7 assume or can even allow the company to use a
8 ratio, an uncollectible ratio that I don't
9 think has ever been higher than the 1% of
10 revenues. You ought to set a more reasonable
11 level, as the company has recognized itself.
12 They are working very hard on taking care of
13 that problem. Now, do I go beyond the test
14 year in that because the company is looking
15 at 1999? Yeah, you could look at it that way
16 but this is an expense, we are not talking
17 about a rate base item or something. So,
18 yes, that's right, it is an incentive on the
19 one hand and also a recognition that there
20 ought to be an improvement made and
21 recognition that the company is, indeed,
22 working on that at this point.

23 Q Given that approach, do you think the
24 Commission should also adopt the practice of

1 including expense items which might increase
2 on a perspective basis or new expense items
3 which might come into existence after the
4 test year end?

5 A I am saying that if the--if you are talking
6 about a known and certain expense, let me
7 give you an example, about the pension
8 expense that Mr. Brown mentioned yesterday.
9 All right. Now, we are of the opinion right
10 now that the most recent pension expense that
11 was given to us, as it was to the Commission,
12 is \$181,000 and you add \$40,000 to it for
13 administrative costs, trustee fees and all
14 that. Mr. Brown, and even though we haven't
15 seen the documentation, he is saying that
16 right now, there apparently is an actuarial
17 report that says that you will be booking a
18 higher level, 267,000 or something like that.
19 If that is indeed the case we will look at
20 the documentation and it became a little
21 fuzzy at the end when you started redirecting
22 and I wasn't--I came away with the impression
23 that maybe that number included life
24 insurance premiums. But no matter what, if

1 we look at it and that indeed is a legitimate
2 cost number, I would accept it. It is a
3 known and certain expense at this point in
4 time. We have not had an opportunity to do
5 discovery on it, but if this can be given to
6 us and indeed it shows that it is a
7 legitimate report of your actuary and all
8 that, and this is, in fact, what you will be
9 booking now, then I think you restate the
10 test year pension expenses and put that
11 amount in.

12 Q Well--

13 A So, we are not here to, you know, to bury
14 you, we are here to try to be fair.

15 Q You come to praise us, not bury us, correct?
16 Mr. Henkes, is the amount that you determined
17 using a four year average on bad debt expense
18 a known and measurable bad debt expense or is
19 that--

20 A It is an objective to shoot for. I think
21 that it is like a more reasonable level than
22 is reflected in the test year.

23 Q You say in your testimony that was submitted in
24 the Alt Reg case that Delta's Alternative

1 Regulation Plan would automatically keep Delta
2 within the return of equity range established by
3 the Commission? It is on page four if you want to
4 refer to it, but I expect you can remember that.

5 A Yes, I do remember that.

6 Q If we assumed that Delta's O&M expenses increased
7 at a much faster rate than the CPI, then Delta's--
8 then the Delta's Alternative Regulation Plan would
9 not automatically allow Delta to earn a return
10 within the zone of reasonableness authorized by
11 the Commission, would it?

12 A If I assume that your O&M expenses increase
13 at a rate much higher than the CPI-U?

14 Q Yes.

15 A Then one must make the conclusion that you
16 will not make your rate of return?

17 Q Correct, it is not going to automatically
18 allow Delta to earn a return within the zone
19 of reasonableness range?

20 A No, I don't agree with that statement at all.
21 First of all, you are confusing things. We
22 are not talking about O&M expenses, you are
23 talking about O&M per customer expenses and,
24 you know, your O&M per customer expenses over

1 the last eight years has been going down, not
2 been going up. So, you are making an
3 assumption here that is totally unrealistic,
4 and then, to say that just looking at that
5 one element should therefore, then, lead to
6 the result that you are not going to make
7 your return, I'm not sure that I can agree
8 with that. That sounds like a very
9 simplified statement that--

10 Q Part of the purpose of the Alternative
11 Regulation Plan is to make this process a
12 little more simple and, the fact of the
13 matter is, if expenses increase faster than
14 the consumer price index, then the consumer
15 price index constraints which are contained
16 within the plan will keep the rates from
17 rising higher than the CPI?

18 A Now, wait a minute, you don't use expenses,
19 you use expenses per employee, so you have
20 got to look at both items. I mean, I don't
21 go for that.

22 Q Okay, fair enough.

23 A That's not your plan.

24 Q Well, let's see if there are some things that

1 we can agree on, how about that?

2 A That would be great.

3 Q Isn't it true that Delta is required to
4 submit a filing with the Commission before
5 the annual adjustment component can be
6 implemented each year?

7 A The AAC?

8 Q Yes, sir.

9 A You have to come in with a filing?

10 Q Yes.

11 A Yes, I agree with that.

12 Q I take it you also agree that with that
13 filing Delta is required to supply the
14 Commission with certain data, including its
15 budget, as well as any other data the
16 Commission deems necessary; you agree with
17 that, don't you?

18 A Yes, lots of stuff.

19 Q Right. Delta is also required to submit a
20 filing with the Commission before the actual
21 adjustment factor, the AAF can be implemented
22 each year; correct?

23 A Yes.

24 Q Delta is also required to submit a filing

1 with the Commission before the balancing
2 adjustment factor, the BAF, can be
3 implemented each year; correct?

4 A Yes.

5 Q Since Delta must submit these filings with
6 the Commission for review before each of the
7 components can be implemented, it is not
8 really an automatic adjustment clause, is it?

9 A It--I would say it is a virtual automatic
10 adjustment clause because the way the
11 procedure is set up it almost sounds like a
12 virtual--I don't say--want to say rubber
13 stamp, but the 30 days to look at it and a
14 couple of telephone conferences and it
15 doesn't sound to me like it is a rigorous
16 review, so particularly if you are talking
17 about a budget where you still have to dig
18 out whether--what is in there and maybe the
19 kitchen sink or what are things there that
20 the Commission in the past has ruled against.
21 To do all that in 30 days is just not
22 realistic, so I'm just making the assumption
23 that not much can be accomplished during that
24 time and, then, under that scenario, it is

1 basically an automatic adjustment clause. I
2 maybe say it a little too strongly, but that
3 is really what I mean.

4 Q And that is your basis for saying it;
5 correct?

6 A There is a lot of other reasons why I say
7 this, this is only one reason. I call it a
8 guarantee--and I think I call it a GREM,
9 guaranteed return on adjustment mechanism,
10 return on equity mechanism, yes.

11 Q But those reasons that you just explained are
12 the ones that are the basis for your
13 statement that it is an automatic adjustment
14 clause regardless of other pejorative things
15 you might want to say about it?

16 A Those plus the fact that you almost--it is
17 virtually dollar for dollar recovery on a--
18 even on a retroactive basis. I mean, one of
19 the big differences between your plan and the
20 Alabama plan, which was never mentioned by
21 the company, by the way, is that in Alabama
22 when you go over the range you have to return
23 the excess of the earnings. When you fall
24 under the range you are not allowed, in

1 Alabama, under the ACC to adjust your rates
2 prospectively to make up for that retroactive
3 adjustment, for the retroactive short fall in
4 earnings. So, any time that during the AAC
5 period in Alabama you are earning under the
6 return on equity, the Alabama Gas Company is
7 not allowed to take that shortfall and build
8 it into their rates for the next period. And
9 I can show that--where that is in the Alabama
10 tariff and, in fact, when we asked the
11 company the question to confirm that, you
12 confirmed that. And I can tell you which
13 data response that is.

14 Q Well, I was a little puzzled by your
15 statement a moment ago that Delta never
16 mentioned what you just described, whereas,
17 on page nine of the initial February 5, 1999,
18 letter to the Commission proposing the
19 Alternative Regulation Plan, there is a
20 paragraph that does explain that matter.

21 A I was just referring to a question that was
22 asked by the Commission where they asked if
23 you list all of the differences, and it was
24 question number 32, between your Alt Reg Plan

1 and the Alabama Alt Reg Plan, this thing
2 certainly wasn't in there. But as you say,
3 it makes a huge difference because that means
4 in Alabama there is no guaranteed earning
5 rate of return, whereas, in your case you
6 have this symmetry built in, you will
7 guarantee it. Because you allow, if you earn
8 under 11. whatever it was, 11.1% for the AAC
9 year, you are allowed to recover that short
10 fall, that retroactive short fall, in your
11 next AAC. They don't allow it in Alabama.

12 Q In your testimony that was filed in the
13 alternative regulation proceeding, it is at
14 pages 22 and 23, but the essence of what you
15 said was that the three performance base rate
16 making mechanisms in Kentucky that we have
17 discussed a good deal, I think it is Western,
18 LG&E--

19 A Yeah.

20 Q --and Columbia.

21 A Columbia.

22 Q Differ from Delta's proposed plan because
23 they have "tough benchmarks that must
24 represent improvements over what the

1 utilities were achieving previously," do you
2 remember that?

3 A Yeah, hard to achieve, tough.

4 Q Yes, you called it tough.

5 A Challenging.

6 Q Have you performed a detailed analysis to
7 determine whether all the benchmarks
8 contained in all of those mechanisms, in
9 fact, represent improvements over past
10 performance by the utility?

11 A No, I think that is irrelevant. The relevant
12 part is, what is the Commission's policy?

13 And the Commission has set a policy in those
14 three cases, and that policy is that under--
15 if you want to have an incentive rate making
16 mechanism, then you have to have benchmarks
17 in there that require exceptional performance
18 and represent improvements over prior
19 actions, and that is the objective. Now, I
20 haven't checked to see whether it was tough
21 and whether they met it or didn't meet it, I
22 mean, to me that is not relevant. What is
23 relevant is what the Commission thinks is
24 important in establishing these incentive

1 mechanisms.

2 Q Well, but didn't you say in your testimony
3 that those three PBR mechanisms contained
4 tough benchmarks?

5 A Yes, I did say that.

6 Q Are you saying today that you don't know
7 whether they do or not; is that right?

8 A Oh, yeah, I can tell you, for instance, what
9 was tough in one those things, okay. In the
10 Columbia case, it had to do with the sharing
11 of capacity release revenues. And Columbia
12 said, okay, we just want to share 50/50,
13 whatever it was, 65/35, I think it was.

14 Q Wasn't that LG&E capacity release?

15 A No, it was Columbia. That was Columbia, 65%
16 back to the customers and 35% retained by the
17 company. And the Commission said no we are
18 going to set a very challenging benchmark.
19 And that is, they looked at highest annual
20 capacity release revenue level in the past
21 and they said that is the benchmark. You are
22 going to have to make those revenues first
23 and you are not going to get one penny of
24 that, that all goes to the ratepayers. And

1 when you beat that then you can start sharing
2 65/35, and I find that a tough benchmark.
3 And when I compare that to your powerful
4 performance based cost controls, there is
5 just no comparison, they are meaningless.
6 And I don't want to say this in a derogatory
7 sense, it is just that there is no incentive,
8 these--this cost control is not really a cost
9 control measure.

10 Q Did you determine whether there were any
11 other components of any of these performance
12 base rate making mechanisms that you cited in
13 your testimony constitute what you call a
14 challenging benchmark?

15 A There were. I think, generally, the
16 Commission used market based prices, but then
17 also decided to reduce those market based
18 prices to reflect certain discounts that once
19 in a while were given by the pipelines, so
20 that you wouldn't just start sharing based on
21 the status quo. You ought to do better than
22 what you did before. I think that was in the
23 Western case, Kentucky case. But, generally,
24 it was market based prices and then taking it

1 one step further.

2 Q Did you look at the Western Kentucky
3 mechanism to determine if, in fact, they
4 require improvement over past performance by
5 the utility or whether they theoretically do?

6 A I looked at--no. Grant you, I looked at the
7 Commission order I did not look at the entire
8 mechanism to try to figure out, you know, how
9 it worked, but I just didn't think that--

10 Q Sure.

11 A --it was important.

12 Q Mr. Henkes, Steve is bringing you a document
13 that, Your Honor, we would like to have
14 marked as Delta Hearing Exhibit Number 3.
15 Mr. Henkes, the document that Steve has
16 handed you is a copy of the LG&E experimental
17 performance based rate mechanism tariff.
18 Have you ever seen this before?

19 A No.

20 Q I believe you testified in the testimony submitted
21 in the Alt Reg case that the three PBRs of LG&E,
22 Columbia and Western are fairly simply to
23 understand, implement and administer, that is at
24 page 24 of your testimony. You said that, didn't

1 you?

2 A Yes, and in that I meant that in the sense

3 that you were talking here about a PBR

4 mechanism within a dollar for dollar recovery

5 clause in the first place, whereby, the

6 decision was made to, in an effort to improve

7 operation and financial performance to make

8 it a system of penalties and rewards by

9 setting certain deadlines. And if you can

10 beat them you can start sharing in it and if

11 you don't then you have some penalties. And

12 the sharing would be 50/50 and the benchmark,

13 I think in LG&E's case, this is presumably

14 market based cases, and there were some

15 thresholds. In that sense I meant to say

16 that, where we are not having three different

17 filings and BAFs and AACs and AAFs and bands

18 and percentages over and under the band would

19 become quite convoluted. I meant it to say

20 in that sense, I mean, if you wanted me to

21 take you through these formulas and try to

22 prove that this is also very complicated, we

23 can do that. But that is the way I meant to

24 say it.

1 Q I take it you would be willing to stipulate
2 that the formulas contained in the PBR tariff
3 of LG&E are extremely complicated, aren't
4 you?
5 A No, I have seen it--
6 Q Well, let's go through them. Let's turn to
7 page 14-D, sheet 14-D.
8 A B?
9 Q 14-D.
10 A D.
11 Q Do you see the formula that is about a third
12 of the way from the top of the page?
13 A Right.
14 Q Would you please explain that for me and to
15 the Commission?
16 A I haven't seen this before so I can't--how
17 can I explain this if you give this to me, I
18 haven't seen it before?
19 Q I thought you just said it was simple?
20 A Maybe when I study it and go home, I look at
21 it and I say the light goes on, I say it is
22 very simple. But when you want me to try to,
23 you know, take this formula and explain it,
24 that is not possible.

1 Q Perhaps what we can do I expect we will be
2 breaking for lunch before I'm finished your
3 testimony, maybe you can study it over the
4 lunch and come back and tell us how simple it
5 is; how about that?

6 A You are going to ruin my lunch.

7 Q Mr. Henkes, it doesn't look simple to me but,
8 you know, I don't do this for a living, and I
9 was just wondering, you know, what was the
10 basis for your statement in your sworn
11 testimony--

12 A I just meant--

13 Q --that this tariff was simple to understand,
14 implement and administer?

15 A That was based on my reading of the
16 Commission Orders as compared to the reading
17 of your plan.

18 CHAIRMAN HELTON:

19 Mr. Watt, this seems to be a good time
20 for us to take our lunch break so that
21 he will have time to look at this.

22 MR. WATT:

23 Okay, he can study it then.

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CHAIRMAN HELTON:

Vivian, if we could go off the record
please

(OFF THE RECORD)

CHAIRMAN HELTON:

Mr. Watt.

MR. WATT:

Thank you ma'am. Just sort of an
administrative detail, Your Honor, we
would move the admission of Delta
Hearing Exhibit Number 3.

CHAIRMAN HELTON:

So ordered.

(EXHIBIT SO MARKED: Delta Exhibit No. 3)

(CONTINUED CROSS EXAMINATION)

BY MR. WATT:

Q Mr. Henkes, did you have occasion to look at the
formula on Sheet Number 14-D of Delta Hearing
Exhibit Number 3 over the lunch hour?

A Yes, I glanced over this plan and in the
interest of time I am willing to stipulate
that none of these plans are simple.

Q Thank you. Do you know what was done by
Louisville Gas & Electric to implement this

1 mechanism?

2 A What was done?

3 Q Yes.

4 A No.

5 Q Would you accept, subject to check, that
6 there are over a 100 pages of calculations
7 filed each quarter by LG&E in connection with
8 this mechanism?

9 A Subject to check, yes.

10 Q Do you know what steps are involved in the
11 Commission's administration of the mechanism?

12 A No.

13 Q Would you please refer to your Schedule RJH-
14 3?

15 A Are we back on the rate case?

16 Q Yes.

17 A Yes.

18 Q The one about ADIT; do you have that before
19 you?

20 A Yes.

21 Q I believe that that schedule shows that ADIT
22 has an adjustment proposed by you of
23 \$666,905; is that right?

24 A Yes. Let me just do a quick check. Yes.

1 Q And that adjustment references Schedule RJH-
2 5; correct?

3 A I see that the two amounts don't reconcile
4 but--

5 Q Do you know what--

6 A I'm trying to figure that out. I mean the
7 666,905 is the difference between what you
8 recommended per books amount of 8,437,000 and
9 the 9,104,000 unless my computer model missed
10 something, let me just--

11 Q Well, we were trying to guess what may be the
12 reason for the discrepancy and--

13 A Oh, I know what it is.

14 Q Okay, go ahead.

15 A I think what it might be is--no, it is not--
16 that is not the reason. I thought it was the
17 allocation to Canada Mountain, but that is
18 not it.

19 Q Well, I think you are on the right track, did
20 you maybe intend to include the fair note
21 amortization of 16,200 and a bad debt reserve
22 of 47,300?

23 A No. What my intention was to use the same--
24 the exact same ADIT components that were

1 allowed by the Commission in the last case.

2 Q Uh-huh.

3 A And those were accelerated depreciation,
4 which is on line one; alternative minimum tax
5 after the rehearing on that, which is on line
6 four; advances for construction, which is on
7 line six; and then the unamortized debt
8 expense of 388,205 and the storage gas of
9 1,100, it gives you 9,103,630. So, the
10 9,103,630 is indeed the number that would be
11 derived based on the Commission approved
12 method. Now, right now; I don't have a--I
13 can try to figure out what that difference
14 is, but the 9,103,630 in the Attorney
15 General's recommended rate base is the
16 correct number.

17 Q Could I get you after we have left here to
18 see if you can reconcile those two numbers
19 from Schedule 3 and Schedule 5 and then
20 provide it to us later?

21 A Sure. I'm sure it is a computer error or as
22 model error or something that didn't pick
23 something up.

24 Q Going back to the Columbia, Western and LG&E

1 PBRs, did you ever perform any sort of review
2 or analysis about how those companies gas
3 supply costs performed in relation to the
4 benchmarks during the five year period prior
5 to the implementation of each utility's
6 mechanism?

7 A No.

8 Q Did you do it for any period prior to the
9 implementation of each utility's mechanism?

10 A No. As I said before, to me the relevant
11 aspect was the language used by the
12 Commission in setting the benchmarks required
13 to have an incentive mechanism.

14 Q Mr. Henkes, in your response to the
15 Commission's Data Request, Item 36, the one
16 about rate case expense, and the
17 normalization issue, do you remember that?

18 A Yes.

19 Q You submitted, as authority for your
20 position, testimony of some guy from Artesian
21 Water Company, I assume he is, why don't you
22 tell me that, is David P.--

23 A State.

24 Q --State, is he an employee of Artesian Water

1 Company?

2 A He is Vice President and Chief Financial
3 Officer, Treasurer.

4 Q Now, is--was it your intention to utilize this
5 fellow's testimony in support for the proposition
6 that normalization is appropriate rather than
7 amortization with respect to rate case expense?

8 A The question was, is the AG aware of any
9 other jurisdiction that uses a normalization
10 methodology for the recovery of rate case
11 expenses, provide a listing of the
12 jurisdiction and a copy of a recent decision
13 describing the use of normalization
14 methodology. So, I think I sent some copies
15 of decisions involving New Jersey, as well as
16 Delaware, sent a copy of a Superior Court
17 Order, recent Superior Court Order in
18 Delaware. And just to complete the picture,
19 I also pointed out that in this current
20 ongoing rate case, Artesian rate case, the
21 company had found out that, by mistake, that
22 they had included rate case expenses for two
23 rate cases. And in their supplemental
24 testimony they took the one rate case expense

1 out which was the one prior to the current
2 one. So, you know, that was the reason why I
3 attached it as well.

4 Q You didn't attach it, I take it because you felt
5 somehow that Mr. State's testimony had more
6 creditability than the testimony of the Delta
7 witnesses that said it ought to be treated
8 otherwise; correct?

9 A No.

10 Q It is just illustrative?

11 A Yes.

12 Q Speaking of the New Jersey decision, are you
13 aware of any New Jersey authority more
14 current than 37 years old for the proposition
15 that rate case expense ought to be normalized
16 rather than amortized?

17 A I'm aware that the one I send you, I didn't
18 have much time to do the research but I found
19 that one in my files and I know it was from--
20 remind me was 1970--

21 Q '62.

22 A '62. There might be more recent ones, I've
23 got to go back and look for them.

24 Q But you didn't look for them and you don't

1 know whether there are, as you sit here
2 today?

3 A Not as I sit here today, no.

4 MR. WATT:

5 That's all the questions I have Your
6 Honor. Thank you Mr. Henkes.

7

8 CROSS EXAMINATION

9 BY MR. WUETCHER:

10 Q Good afternoon Mr. Henkes. Have you reviewed
11 Delta's response to Item 23 of the Commission's
12 Order of September 14, 1999?

13 A I need to see a copy of that.

14 Q Okay. Item 23 of Delta's response to the
15 Commission's order of September 14.

16 MR. WUETCHER:

17 Of 99-176.

18 MR. WATT:

19 He has got it.

20 Q Do you have it to Item 23?

21 A I'm looking at it. I've not seen that
22 before.

23 Q Okay. Well, let me go on to my next question
24 and it may become apparent to you. These are

1 somewhat similar to what Mr. Brown was asked
2 yesterday. Based upon this response, would
3 you agree that Delta's pro forma payroll that
4 would be charged to operations and
5 maintenance expense would be \$4,612,184?

6 A Now, you have to tell me how you got that.

7 Q If you will go to page four of the response,
8 right down at the bottom that would be six
9 million--

10 A 125?

11 Q Whoops, wait a second, sorry, page five,
12 6,213,582, the last figures on the page, at
13 the very right hand?

14 A Yep.

15 Q Okay. That's total payroll minus \$1,595,398
16 from capitalized labor?

17 A And where is the one million?

18 Q Which is found on the next page.

19 A Minus 1,595--

20 Q 398?

21 A Yes.

22 Q And then minus \$6,000 related to
23 subsidiaries, that figure being found on the
24 first page in Response C? It adds to

1 4,612,184?

2 A Yes.

3 Q Would you agree that based on that response
4 that is what maintenance expense should be?

5 A That's what the--

6 Q I'm sorry, but Delta's pro forma payroll that
7 would be charged to operations and maintenance
8 expense would be?

9 A Yes.

10 Q Would you agree, subject to check, that by
11 subtracting the actual payroll charged to
12 operations and maintenance expense, the
13 \$4,531,719 from pro forma payroll of
14 4,612,184, a payroll adjustment of 80,465
15 would result?

16 A Yes, and that's \$5,500 less than what I had
17 recommended on Schedule RJH-10.

18 Q Okay. Let's go to rate case expense. In
19 Case Number 97-066 the Commission determined
20 that Delta's rate case expense of \$101,350
21 should be amortized over a five year period.
22 Given the Commission's determination in the
23 prior rate case, why should Delta not be
24 permitted to include \$20,270 in rate case

1 amortization in this proceeding?

2 A I gave a long response in a data response on

3 that. I believe that for rate case expenses

4 one should apply what I would call the

5 normalization method, which I think you

6 should apply to expenses that are associated

7 with a recurring aspects of the company's

8 operations. It doesn't necessarily have to

9 happen every year but it comes about every

10 two or three years or every year, and it

11 doesn't have to be at the same amount, it can

12 vary. I think rate case expenses are an

13 expense that fits in that category.

14 Amortization expenses, I think, should be

15 applied to items of an extraordinary nature,

16 storm damage expenses, flood expenses, a

17 Commission ordered management audit, for

18 instance. You don't know when this is going

19 to happen and when it happens you don't know

20 how much it is going to cost. Sometimes it

21 is 100,000, sometimes it is a million, so in

22 those cases I think you can have amortization

23 where you essentially have dollar for dollar

24 recovery. Rate case expenses, I think you

1 say, okay, we will amortize it, we will use a
2 five year amortization period, or a three
3 year amortization period, and that's the
4 level we set in the rates. Now, if the rates
5 are in effect for two years and you are
6 missing out on one year, that's too bad. If
7 the rates are in for five years, then they
8 gain two years, so it always balances out. I
9 don't agree with the concept that you can
10 have a rate case expense at \$25,000 in this
11 case because the company recovered it for two
12 years. At the same time you have the
13 management audit amortization expense in this
14 case, \$64,000 that is being amortized over
15 three years, and I'm referring to AG 25, by
16 the way, all the data is on there. It is
17 being amortized over three years, it has been
18 recovered in 1998, it is being recovered in
19 1999, there is one year left. Now, unless
20 the rates of this company change at the end
21 of 2000 the company is going to over recover
22 \$63,000 a year for management audit. If you
23 want to include the \$24,000 of the rate case
24 expenses in this case, I suggest we take the

1 63 for the management audit and reamortize it
2 over three years and, therefore, only include
3 21,000 in the test year and make a \$40,000
4 adjustment. I think you ought to be fair and
5 in this case apply symmetry.

6 Q Do you agree with Delta's proposed three year
7 amortization rate cost for the rate case
8 expenses incurred in this proceeding?

9 A I thought--let me put it this way, I know
10 that the Commission in the last case used
11 five years. I know the company originally
12 filed for five years. I think the company
13 during the proceeding came back and said it
14 ought to be three years, I think it is a
15 matter up to the Commission to decide, you
16 know, whether it is three or five years. I
17 think that if, for some reason, the
18 Commission were to give consideration to the
19 ARP or to the weather normalization clause,
20 the Commission should definitely think more
21 about the five year amortization than the
22 three year amortization.

23 Q Should the Commission consider recovery--
24 Delta's recovery of the Mt. Olivet plant

1 acquisition adjustment in establishing rates
2 in this proceeding?

3 A I was asked that question and we didn't have any
4 data on it, so I basically had a non-answer saying
5 I hadn't had time to study it. I know that you
6 asked the same question of Delta, the revenue
7 requirement index is \$8,300, I think. I don't
8 know what this acquisition is all about. All I
9 know is that, at least from the Company's
10 calculations, has a very small revenue requirement
11 impact. If it has to do with use and useful
12 services delivered to this company's ratepayers,
13 then you would think that you would include it.
14 But we haven't had any time to discover on it.

15 Q Okay. Well, let me try to focus down on a
16 narrow issue involving that. The acquisition
17 of the Mt. Olivet plant has not been
18 completed, according to Mr. Jennings'
19 testimony. Assuming that it has not been
20 completed, should--and just bearing that in
21 mind just on that sole issue alone, not
22 withstanding any other considerations that
23 you might get in looking at it, should the
24 Commission consider Delta's recovery of that

1 acquisition adjustment in this proceeding?

2 A No, if the acquisition hasn't taken place
3 then no aspects of this acquisition should be
4 included in this case, rate base, expense,
5 revenues, nothing.

6 Q Okay. Then you would agree that any type of
7 rate making treatment should be deferred
8 until the acquisition is completed?

9 A Yes.

10 Q Are you aware of any other jurisdictions that
11 would allow a utility to recover the cost of an
12 investment similar to Delta's Canada Mountain
13 storage assets through a gas recovery mechanism
14 rather than through general rates?

15 A No.

16 Q One final question, you were asked a series
17 of questions regarding the Louisville Gas &
18 Electric Company's tariff. Would you agree
19 if I--assume for a moment that that tariff
20 was originally part of LG&E's proposal in its
21 entire format, would you agree that it could
22 not be said to be lacking in specifics, as
23 far as how that provision was going to
24 operate?

1 A Yes.

2 MR. WUETCHER:

3 That's all we have, thank you.

4 MR. WATT:

5 Your Honor, I have just a couple of recross
6 questions.

7

8 RECROSS EXAMINATION

9 BY MR. WATT:

10 Q Mr. Henkes, during Delta's last rate case, 97-066
11 in which you testified, didn't you propose that
12 Delta amortize rate case expenses in that case?

13 A Semantics. In other words, I proposed that
14 whether you call it amortize or normalize, I
15 think that you say, okay, what is the cost of
16 this rate case, the estimated cost. Let's
17 say it is \$150,000. And then you say, okay,
18 now, what level of cost am I going to build
19 into the annual rates so that I give the
20 company an adequate allowance to cover
21 ongoing rate case expenses. So, we can say
22 I'm going to amortize it over five years or
23 I'm going to use an amortization period of
24 five years or a normalization period of five

1 years, I agree that I'm using normalization
2 for the first time in this case and not in
3 the last case, and that may be a little
4 confusing but the intent was there. The
5 intent that I had in the last case is the
6 same as I have in this case.

7 Q Do you believe that any unamortized rate case
8 expense should be included in Delta's rate
9 base?

10 A No. You don't--the moment you talk about
11 normalized expenses you don't have any
12 unamortized expense in the rate base. You
13 only have that with amortization, deferrals
14 and amortization.

15 Q Is that another semantic issue?

16 A No.

17 MR. WATT:

18 That's all I have, Your Honor.

19 CHAIRMAN HELTON:

20 Mr. Wuetcher.

21 MR. WUETCHER:

22 No, we have no further questions.

23 CHAIRMAN HELTON:

24 You may be excused.

1 MS. BLACKFORD:

2 Thomas Catlin.

3 (WITNESS DULY SWORN)

4

5 The witness, THOMAS S. CATLIN, having first been
6 duly sworn, testified as follows:

7 DIRECT EXAMINATION

8 BY MS. BLACKFORD:

9 Q Would you state your name and business address for
10 the record, please, sir?

11 A Certainly, my name is Thomas S. Catlin, C-a-
12 t-l-i-n, and my business address is Exeter
13 Associates, Incorporated, 12510 Prosperity
14 Drive, Suite 350, Silver Spring, Maryland.

15 Q Mr. Catlin, are you the same Thomas Catlin
16 who filed testimony in the matter of 99-046,
17 Delta Natural Gas, Inc., to implement an
18 experimental Alternative Regulation Plan on
19 January 30?

20 A I am.

21 Q And are there any amendments or corrections
22 that you wish to make in your testimony?

23 A Yes, I need to make two corrections. On page
24 10, line 15, the number there "2.28" should

1 be "2.36." And on page 16, line 24, the case
2 reference to 99-070 should be "99-176."

3 Q And with those amendments or corrections,
4 were I to ask you the same questions today,
5 would your responses be the same as given in
6 that testimony?

7 A They would.

8 MS. BLACKFORD:

9 I move his testimony into the record and
10 the witness is available for cross.

11 CHAIRMAN HELTON:

12 So ordered. Mr. Watt.

13

14

CROSS EXAMINATION

15 BY MR. WATT:

16 Q Mr. Catlin, before you get off page 16, the change
17 that you just made with reference to Case Number
18 99-070, you changed it to 176. 99-070 is Western
19 Kentucky Gas' general rate case, are you a witness
20 in that case?

21 A No, I'm not.

22 Q Why did you put 070 in there?

23 A I gra--I was looking for the filing reference
24 and I just picked the wrong one off of the

1 sheet that was in our office.

2 Q Would you please turn to page ten of your
3 testimony.

4 A I have that.

5 Q I'm paraphrasing, frankly, but I just want
6 you to confirm that you say on that page that
7 the O&M expense controls contained in Delta's
8 proposed Alt Reg Plan are not likely to
9 impose "any real limitation" on the increases
10 in O&M expenses which can be passed through
11 to ratepayers; did I correctly paraphrase
12 your testimony?

13 A Yes.

14 Q Is that statement based, at least in part, on
15 the rate of change in Delta's non-gas O&M
16 cost for the five year period from '93
17 through '98, as compared to the increases in
18 the CPI-U?

19 A It is based on the change in the cost per
20 customer. Over the historical period the O&M
21 cost per customer relative to the--both on a
22 stand alone basis and relative to this CPI-U.

23 Q Was that done over a five year period?

24 A Yes, '93 through '98, that's the changes in

1 '94, '95, '96, '97 and '98, relative to '93.

2 Q You understand, don't you, that Delta's
3 proposed Alt Reg Plan calls for the O&M
4 expenses reflected in the base rates to be
5 re-established every three years?

6 A I believe Mr. Seelye indicated that in his
7 testimony. However, other than the--after
8 the end of the experimental period I didn't
9 see anything nor did I hear anything in the
10 last two days that wouldn't require the O&M
11 expenses to be re-established every three
12 years. In fact, at the end of the three year
13 experimental period it is not necessarily the
14 case that they would have to be re-
15 established.

16 Q But at least at the outset your five year
17 comparison is really sort of an apples and
18 oranges comparison to Delta's three year
19 experimental period; isn't it?

20 A Well, I don't think so. I think the fact
21 that over the--whether you look at three
22 years or five years, the fact that the O&M
23 cost per customer have declined if you extend
24 the period--I will grant that the amount of--

1 the difference in the O&M relative to the
2 CPI-U that the over-recovery amount could
3 vary, or will vary, depending on how many
4 years. But I was really relying on this
5 primarily to focus on the fact that an O&M
6 cost per customer were declining. And so, if
7 you set a standard--a performance based
8 standard that allows them to increase at the
9 rate of the growth from the CPI-U with a
10 1 1/2% allowance, you are really not imposing a
11 true performance based incentive on cost control.
12 If just the 1 1/2% allowance is--if you are
13 limiting it to three years is an additional half a
14 percent per year. And that was really my point, I
15 didn't want to get hung up on specific dollar
16 amounts, it was the concept of are we really
17 imposing a true limitation here or not.

18 Q Well, you just mentioned that over this five
19 year period Delta has managed to hold down
20 the rate of change in its non-gas O&M cost to
21 a level that is less than the rate of
22 inflation. Is it your position that the
23 Commission ought to come up with some tougher
24 index or measure to somehow penalize Delta

1 for its efforts to hold down cost? That's
2 not your position, is it?

3 A I'm not proposing to penalize Delta, no.

4 Q But you think there ought to be some tougher
5 measure; is that what you are saying?

6 A Well, if you are going to--I think it is a
7 generally accepted concept that if you are
8 implementing a performance based form of
9 regulation, if you are implementing a
10 performance based control in the
11 determination of what rates will be, the
12 object is not to reward for achieving less
13 than what is historically been accomplished
14 without the performance based measure.
15 Normally, a performance based measure is
16 established relative to historical
17 accomplishment and the object is to reward
18 the utility for performing better than has
19 occurred historically. That has certainly
20 been the case in the various performance
21 based investigations and proceedings that I
22 have been involved in.

23 Q Mr. Catlin, can I get you to make some
24 assumptions for purposes of a question I'm

1 going to ask you later. Would you assume
2 that Delta's Alternative Regulation Plan is
3 in effect today. And would you then also
4 assume that Delta's O&M cost increases were,
5 in fact, less than the increases in the
6 CPI-U. And let's finally assume that you are a
7 customer of Delta, okay?

8 A Okay.

9 Q Wouldn't your rates be lower than they would
10 otherwise be if Delta's O&M cost increases
11 were equal to or greater than the increasers
12 in the CPI-U?

13 A Just repeat your last question again, I'm sorry?

14 Q That's okay. Wouldn't your rates, given
15 those three assumptions I just gave you,
16 wouldn't your rates be lower than they would
17 otherwise be if Delta's O&M cost increases
18 were equal to or greater than the increases
19 in the CPI-U?

20 A If costs grow at a lesser rate and you are
21 passing through the changes in cost through
22 the mechanism each year, yes.

23 Q Mr. Catlin, you said in your testimony,
24 specifically at page seven, lines 12 through

1 13, that Delta's Alternative Regulation Plan
2 provides guaranteed recovery of Delta's
3 costs; do you remember saying that?

4 A Yes.

5 Q Is this simply your opinion from having examined
6 the plan?

7 A Yes.

8 Q You didn't perform any analysis of all the
9 components of the proposed plan, including
10 the proposed cost controls that on your part
11 support that assertion?

12 A No, I did base it on my analysis of what I
13 thought would occur under the plan based on
14 the information that had been provided in
15 this case, including recognition of the cost
16 controls or the performance based controls
17 that were added subsequent to the original
18 filing.

19 Q Is that analysis in writing or are there work
20 papers that go with it?

21 A No. It is based on my analysis as I've tried
22 to explain it in my testimony.

23 Q So, if we wanted to look at your analysis,
24 the only way we could do it would be just ask

1 you questions about it or read your
2 testimony?

3 A That's correct.

4 Q You have stated in your testimony that the
5 GDP-PI, the gross domestic product price
6 index, is more representative of price
7 increases experienced than the CPI-U proposed
8 by Delta to measure O&M cost; did I correctly
9 state your position?

10 A I think more or less, yes. I mean, I don't
11 know that I've used those--that exact words
12 but, conceptually, that is what I've stated,
13 yes.

14 Q Would you turn to Item Number 51 of Delta's data
15 request to the Attorney General? I want to
16 apologize, I keep asking you all to turn to the
17 item of the request, I'm really wanting you to
18 turn to your response.

19 A I understood that and I have that, I have a
20 copy of it.

21 Q If you look at the request there, we ask you
22 to provide the monthly GDP-PI values for the
23 past 20 years; right?

24 A Yes.

1 Q And your response was that the values are
2 published on a quarterly basis and are
3 available in various publications of the
4 United States Government and you didn't
5 attempt to identify all of the values;
6 correct?

7 A That's correct.

8 Q So, you didn't provide the requested
9 information, right?

10 A I cited where it could be found, I didn't
11 have all the requested information.

12 Q The CPI-U is published monthly rather than
13 quarterly, isn't it?

14 A It is.

15 Q Don't you believe that a more frequently
16 published report would be a preferable index
17 for something like Delta's Alt Reg Plan?

18 A Not necessarily. I think the better or more
19 important measure is--or the more important
20 factor is the applicability and the
21 representativeness of the index that is being
22 used, not how often it is published.

23 Q Isn't transportation a component of the CPI?

24 A Is it a component?

1 Q Yes.

2 A Yes, it is.

3 Q Aren't gasoline prices reflected in that
4 index?

5 A There--they are a component, yes.

6 Q Heating fuel and electricity, those two items
7 are a component; correct?

8 A What was the specific component?

9 Q Heating fuels and electricity?

10 A Fuels and utilities are one cost, but it is
11 included.

12 Q I'm sorry, go ahead and finish.

13 A Are one cost that is included or one
14 component.

15 Q Are those the kinds of cost that are included
16 in Delta's O&M expenses?

17 A Yes, but the major component of--the major
18 component, the single largest component of
19 the CPI-U is housing, and I don't think that
20 that is a cost that is included or have a
21 determinate of Delta's costs or the
22 increases. And I would also note that
23 changes in the cost of fuels, changes in the
24 cost of transportation are also a factor in

1 the GDP-PI. It is my recommendation with
2 regard to the GDP-PI is that it is simply a
3 broader index, it is a broader measure of the
4 changes in prices. The CPI-U is fairly
5 narrow, narrowly defined measure of price
6 changes.

7 Q Aren't changes in wage rates more likely to
8 approximate the CPI than the GDP?

9 A I haven't--I haven't looked at that but I
10 wouldn't necessarily think so, no.

11 Q Aren't most labor contracts drafted in such a
12 fashion that the adjuster that is used in it
13 is CPI and not GDP?

14 A I think there was a point in time where that
15 was common, I think that is far less common
16 now. I think most contracts have fixed, most
17 wage contracts have fixed rates of change
18 that are negotiated between the parties that
19 are parties to the contract.

20 Q So, they don't use GDP either, then, do they?

21 A I think that is true. I don't think they are
22 specifically indexed.

23 Q Do you know whether or not this Commission
24 has ever used the GDP-PI to normalize costs

1 in rate cases?

2 A I don't know specifically. I do know that
3 they have used the GDP-PI in a performance
4 based regulation arrangement.

5 Q Do you know whether or not this Commission
6 has ever utilized CPI-U to normalize costs in
7 a rate case, costs such as storm damage or
8 expenses and the like?

9 A I do not.

10 Q Would you turn to your response to Delta's
11 Data Request, Item 51(c), please, sir?

12 A I have that.

13 Q The last sentence of that response reads "As
14 such, Mr. Catlin believes that the GDP-PI is
15 more likely to be reflective of the effects
16 of inflation on Delta than is CPI-U," did I
17 read that correctly?

18 A You left out the word "the" before CPI-U, but
19 yes. I mean, I'm not--you asked me if you
20 read it correctly and you did leave out a
21 word, I'm not trying to be--I know that
22 didn't sound right.

23 Q Do you have any--in that request we asked you
24 to provide any empirical evidence that

1 supports your assertion that the GDP-PI is
2 more representative, and you didn't provide
3 any, did you?

4 A What I told--what I think I ex--I did not
5 provide any specific surveys or empirical
6 data of others. What I told you is what I
7 thought it was based on what each index
8 measured and the relative components of each
9 of the indices. Other than that, the answer
10 was no.

11 Q In Item 51(e) where we had asked you to
12 provide copies of economic journals or other
13 authorities that support your conclusion, you
14 didn't provide any, did you?

15 A No, I did not.

16 Q Are you aware that the Alabama Commission has
17 adopted the CPI-U as the index to be used in
18 Alagasco's Alt Reg Plan?

19 A Yes, I am. And I think I addressed that in
20 one of my responses, as well, and indicated
21 that I had no information on how the CPI-U
22 was selected there and there was no
23 information provided in this case that would
24 suggest that CPI-U was the better measure for

1 Delta.

2 Q Would you turn to page 14 of your testimony?
3 At the very top of the page you say, "There
4 will no longer be any review made to
5 establish the net plant in service and other
6 assets devoted to providing public utility
7 service on which the company is entitled to
8 earn a return." Is that right?

9 A Yes.

10 Q You agree don't you that Delta must submit a
11 filing with this Commission each and every
12 time a change takes place under the Alt Reg
13 Plan?

14 A Yes.

15 Q You are not suggesting by your testimony on
16 page 14 that the Commission is not going to
17 thoroughly scrutinize those filings, are you?

18 A I'm not sure what the Commission's ability to
19 thoroughly scrutinize the filing would be within
20 the time frame that has been allotted, but my
21 specific reference here was devoted--or was--
22 attempted to refer to the fact that the
23 Alternative Regulatory Plan was set up to be based
24 on a return on capitalization and, as I understood

1 from the last case, and I did hear the controversy
2 this morning or the discussion this morning about
3 prior practice, but I had understood that at least
4 as of the last case that the Commission was
5 calculating return on rate base. And that is not
6 the way the ARP was set up, it is a return on
7 capital rather than a return on rate base.

8 MR. WATT:

9 Thank you Mr. Catlin. I have no further
10 questions Your Honor.

11 MR. WUETCHER:

12 No questions.

13 CHAIRMAN HELTON:

14 You're excused.

15 MS. BLACKFORD:

16 Stephen Estomin.

17 (WITNESS DULY SWORN)

18

19 The witness, STEPHEN ESTOMIN, having first been
20 duly sworn, testified as follows:

21 DIRECT EXAMINATION

22 BY MS. BLACKFORD:

23 Q Dr. Estomin, would you please state your full name
24 and business address for the record please?

1 A It is Stephen Estomin, my business address is
2 Exeter Associates, Incorporated, 12510
3 Prosperity Drive, Suite 350, Silver Spring,
4 Maryland.

5 Q Are you the same Steve Estomin who caused
6 testimony to be filed on behalf of the
7 Attorney General in Case Number 99-176
8 consisting of both testimony and exhibits, I
9 believe,--

10 A I am.

11 Q --on September 23 of this year?

12 A I am.

13 Q And do you have any corrections or amendments
14 that you need to make to that testimony?

15 A I do not.

16 Q Were I to ask you those same questions, would
17 you give the same response as given in that
18 testimony?

19 A I would.

20 MS. BLACKFORD:

21 I move the testimony into the record and
22 hold the witness available for cross.

23 CHAIRMAN HELTON:

24 So ordered. Mr. Watt.

1 MR. WATT:

2 Thank you, Your Honor.

3

4

CROSS EXAMINATION

5 BY MR. WATT:

6 Q Good afternoon.

7 A Good afternoon.

8 Q Mr. Estomin, you've never prepared a utility cost
9 of service study prior to this proceeding have
10 you?

11 A That's correct, and I didn't prepare one in
12 this proceeding.

13 Q Prior to this proceeding you had never
14 prepared a zero intercept analysis as part of
15 a professional study, have you?

16 A That's correct.

17 Q Would you please look at your response to
18 Item 71 of our data request to the Attorney
19 General? Do you have that before you?

20 A Yes, I do.

21 Q I believe in response to that question you stated
22 that you were unaware of any cases in which the
23 Commission has subsequently rejected the zero
24 intercept methodology utilized by Delta in this

1 proceeding and substituted either your methodology
2 or a similar methodology in its place; correct?

3 A That's correct.

4 Q Have you since become aware of any?

5 A No, I have not. I have not looked into that.

6 Q Would you look at your response to Number 72
7 on the same data request? There you said
8 that you were unaware of and you were unable
9 to provide copies of any cost of service
10 studies that utilized the weighted least
11 squares methodology performed by you; isn't
12 that right?

13 A That's correct.

14 Q I take it you still haven't found any?

15 A That's correct. But let me back up a step,
16 if you are--the least cost approach that you
17 are discussing, I believe, is the one where
18 W, the weight, is used as a weight to
19 multiply the variables in the equation by,
20 that's correct. That, as you are aware, is
21 not the approach that I'm recommending in
22 this proceeding.

23 Q Would you look at Item 73? Again, you said
24 that you had not analyzed and you were

1 unaware of any Commission orders that support
2 the weighted least squares approach utilized
3 by you; is that right?

4 A That's correct.

5 Q You still haven't found any?

6 A That is correct.

7 Q Mr. Estomin, isn't one of the purposes of a
8 regression analysis--I'm like everybody else,
9 I'm having trouble with in this proceeding,
10 let me back up and start over. Isn't one of
11 the purposes of a regression analysis to
12 determine a best fit curve which is
13 representative of the data being analyzed?

14 A That is one of several factors that need to
15 be considered and probably not the most
16 important and, specifically, in reference to
17 the fit.

18 Q Well, I think my question said isn't this one of
19 the purposes, do you agree with that?

20 A That would be correct, it is one of the
21 purposes.

22 Q Would you agree that if the pipe size and the cost
23 of each and every foot of pipe were known, a
24 weighted least squares regression analysis would

1 be unnecessary?

2 A Yes, that is correct.

3 Q When the data is grouped by size and we only

4 know the total cost and total feet in each

5 sized category, shouldn't the regression

6 methodology used to calculate the zero

7 intercept and the slope produce the same

8 results as an ordinary least squares

9 regression would produce if the size and cost

10 of each foot of pipe were known?

11 A Yes. That example is generated in Mr.

12 Seelye's rebuttal testimony and I have

13 absolutely no disagreement with the

14 econometrics shown therein.

15 Q Well, you sort of were getting to the next

16 point that I had. You have looked at Mr.

17 Seelye's rebuttal testimony at pages 2

18 through 21 of his rebuttal testimony?

19 A That's correct.

20 Q And you don't have any problem with the

21 econometrics in that discussion; is that right?

22 A No, I don't have any problems with his

23 calculations or his example, it is correct.

24 My issue with this approach is several fold.

1 One, the approach utilized by Mr. Seelye is
2 not consistent with the instructions clearly
3 contained, in my mind, in the NARUC Manual.
4 Furthermore, my view is that a weighted
5 regression for purposes of the zero intercept
6 is not the appropriate way to go and instead
7 an unweighted regression ought to be
8 utilized. But, certainly, I have no problem
9 with the econometrics that are contained in
10 Mr. Seelye's rebuttal testimony.

11 MR. WATT:

12 I don't have any further questions for
13 Mr. Estomin. I have no further
14 questions Your Honor.

15 VICE CHAIRMAN HOLMES:

16 Staff?

17 MR. WUETCHER:

18 Could we have just one minute.
19

20 CROSS EXAMINATION

21 BY MR. WUETCHER:

22 Q In your opinion, how valid is the theory
23 underlying the zero intercept methodology; that
24 is, that a single variable linear relationship

1 between unit cost of mains, in dollars per foot,
2 and the gas flow capability of a pipe which is
3 proportionate to its diameter?

4 A I'm sorry, can you please repeat the question
5 again?

6 Q I was afraid you were going to ask me that.
7 In your opinion, how valid is the theory
8 underlying the zero intercept methodology;
9 that is, a single variable linear
10 relationship between the unit cost of mains,
11 in dollars per foot, and the gas flow
12 capability of a pipe which is proportionate
13 to its diameter?

14 A If the question is in one sense, it
15 is a pretty straight forward underlying
16 theory on this. And that is, you have the
17 cost of pipe and that is going to be related
18 to some measure of the size of the pipe. In
19 this particular instance, however, what also
20 needs to be considered, in part, is the
21 quality of the underlying data used to make
22 the estimation, which, frankly, I don't
23 believe any economist would feel comfortable
24 in using. These are data of book cost that

1 span decades. There is no adjustment for
2 inflation, the costs are very much apples and
3 oranges.

4 Q Do you think it would be better if it was
5 modeled as a multi-variant equation?

6 A If your question is whether this model, as
7 specified, and the general proposition is
8 misspecified, I'd have to say yes, it is. If
9 we look at the data, for example, we notice
10 that there are pipes of plastic and also of
11 steel, at a minimum one could make, I think,
12 a very good argument that at least there
13 ought to be a dummy variable included in
14 there to represent whether the pipe is steel
15 or plastic. Frankly, for this type of
16 analysis one what--what one would do with the
17 resulting coefficient after applying that
18 dummy variable I'm not sure, or how that
19 would be incorporated into the results to be
20 used by this Commission. So, I think there
21 are certainly some other variables that could
22 go a long way, perhaps, in improving the
23 equation from a specification standpoint.
24 Again, there is also, as I mentioned before,

1 the time component associated with the
2 underlying data themselves.

3 Q In performing your analysis, was there a
4 check of heteroskedasticity, and let me spell
5 that out again, because I'm having a hard
6 time pronouncing it, h-e-t-e-r-o-s-k-e-d-a-s-
7 t-i-c-i-t-y?

8 MR. WATT:

9 There is some heteroskedasticity in the
10 air around here today.

11 A Yes, I--as part of my initial analysis on
12 this and provided to the company in response
13 to a data request, I performed what is
14 referred to as a white heteroskedasticity
15 test which is basically a general test of the
16 present of heteroskedasticity. The results
17 of that test indicated that there was no
18 evidence of heteroskedasticity. Subsequent
19 to that, in the last several days, I ran some
20 additional tests, actually, about 12
21 additional tests, including a forecast, a
22 Glejser test, several variations of that, and
23 Goldfeld-Quandt test for heteroskedasticity
24 and none of those indicated the presences of

1 heteroskedasticity.

2 Q We'd like to have copies of all your test
3 results, but if I could, since I think it had
4 previously been agreed that Commission staff
5 would be permitted to submit written
6 questions to both sides on some of the more
7 technical issues regarding the cost of
8 service studies, we will simply make that
9 request when we tender our written questions
10 to the parties on Monday.

11 MR. WATT:

12 I think we could breeze through
13 something real simple like
14 heteroskedasticity pretty easily here.

15 MR. WUETCHER:

16 That's fine, which is precisely why
17 Commission Staff counsel preferred to do
18 it by written questions.

19 CHAIRMAN HELTON:

20 Maybe we should just coin an acronym for
21 this phrase as we do in all the other
22 utility industries for all of these
23 things?
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MR. WUETCHER:

Well, fortunately for me anyway, I think that is the last time I have to mention that term today.

Q In Exhibit 1 of your testimony, several pages display the unweighted statistics of regression equation results. And, in fact, on pages one, two, four and five the R square is negative, which does not accord to economic theory and is an indication that there is a serious problem. Given this answer, the following, "What were the equations that produced the negative R square values and what is the purpose for inclusions in the exhibit?" And let me ask if it--if you are required to produce those equations if you would prefer to wait and do that in response to our written questions? We can defer that in order to save time, would you prefer--

A I would prefer to do that.

Q What results are obtained when the minimum investment method is used to allocate demand and customer charges?

1 A The minimum investment method?

2 Q Method, or minimum system method?

3 A I don't know, I'm generally familiar with
4 that but I don't believe those results have
5 been presented here.

6 MR. WUETCHER:

7 That's all we have, thank you.

8 MR. WATT:

9 I have a couple more questions.

10 CHAIRMAN HELTON:

11 Did you have any?

12 MS. BLACKFORD:

13 No.

14

15 RECROSS EXAMINATION

16 BY MR. WATT:

17 Q Mr. Wuetcher asked you a few questions about the
18 zero intercept method, maybe just one question.
19 You are aware, aren't you, Mr. Estomin, that in
20 Delta's last rate case, Number 97-066, this
21 Commission explicitly stated their preference for
22 the use of the zero intercept method?

23 A That's my understanding, yes.

24 Q Did your ordinary least squares take into

1 consideration the time element of the cost?

2 A No, it did not.

3 MR. WATT;

4 That's all I have, thank you.

5 CHAIRMAN HELTON:

6 Mr. Wuetcher, do you have anything else?

7 MR. WUETCHER:

8 I have no follow up, gratefully.

9 CHAIRMAN HELTON:

10 You're excused.

11 MS. BLACKFORD:

12 Carl Weaver, please.

13 (WITNESS DULY SWORN)

14

15 The witness, CARL WEAVER, having first been duly
16 sworn, testified as follows:

17 DIRECT EXAMINATION

18 BY MS. BLACKFORD:

19 Q Dr. Weaver, would you please state your full name
20 and business address for the record please?

21 A Yes, my name is Carl Weaver, my address is 4713
22 Wengers Mill Road, Linville, Virginia 22834.

23 Q Are you the same Carl Weaver who caused to be
24 filed on behalf of the Attorney General testimony

1 and exhibits in Case Number 99-046 on July 30 of
2 this year?

3 A Yes, I am.

4 Q And are you the same Carl Weaver who caused to be
5 filed testimony and exhibits on behalf of the
6 Attorney General in Case Number 99-176 on
7 September 23 of this year?

8 A Yes, I am.

9 Q Do you have corrections or amendments that
10 you need to make to either of those
11 testimonies?

12 A Yes, I do. Let's do the 99-046 filed on July
13 30. This will be outside of the packet that
14 was sent with the filing of the 99-176, where
15 we had--I sent some replacement pages. In
16 99-046, page 17, page 17, line two, midway
17 down the line, "Delta uses a 60"--and I have
18 "64.4" that should be "65.4." Also, on the
19 next page, page 18, line 21, which is not
20 numbered, it is the bottom line, the
21 beginning of the last sentence that starts on
22 that page, for the "five" companies, change
23 the "nine" to "five" please. Over two pages
24 to page 20, line 12, please change the "9" to

1 "5." And, also, up on line seven on page 20,
2 "9" to "5." One more of those on the next
3 page, line two, midway down the line, "9" to
4 "5." Now, if we please turn to the 99-176
5 filed on September 23, okay, on line 22--

6 MR. WATT:

7 Page 22.

8 A --Excuse me, page five, line 22, the "8.8 to 10.9"
9 should be "9.5 to 10.8." And then in the back of
10 that testimony the replacement pages that I sent,
11 on page 37 at line 15, the "10.82" should be
12 "10.92." That completes the corrections.

13 Q With those amendments and corrections, were I
14 to ask you the questions posed in these
15 testimonies, would you answers be the same
16 today?

17 A Yes, they would.

18 MR. BLACKFORD:

19 I move the testimonies into the record
20 and hold the witness available for
21 cross.

22 CHAIRMAN HELTON:

23 So ordered. Mr. Watt.

24

1 MR. WATT:

2 Thank you, Your Honor.

3

4

CROSS EXAMINATION

5 BY MR. WATT:

6 Q Good afternoon.

7 A Good afternoon.

8 Q Is it true that the return on equity for the
9 five companies in the panel of companies that
10 you utilize in your testimony would average
11 from 9.75% to 10.75%?

12 A The 9.75 to 10.75 is the result after the
13 adjustment that I made for Delta. I
14 increased the range that I found--and it is
15 not an average, per se. The determination of
16 the cost of equity in the final analysis is
17 always a judgement decision. You use the
18 various models to obtain information about
19 what capital market participants are thinking
20 about the cost of equity. The cost of equity
21 is determined in the capital market, not by
22 me, I'm just trying to see what the capital
23 market reflects. And so, I used these models
24 to obtain as much information as I can and,

1 then, on the basis of that information you
2 make a judgment decision.

3 Q Dr. Weaver, could you please turn to page 38 of
4 your rate case testimony, line 15, and really line
5 16 as well. It appears to me from your testimony
6 on line 15 that the equity for the five companies
7 themselves would average 9.75 to 10.75 and
8 thereafter you made the adjustment for Delta. Did
9 I interpret that correctly?

10 A You are correct, I misspoke, the 9.75 was a
11 decision made on the basis of the data that I
12 examined to be the cost of equity for the
13 five companies and the 10.25 to 11.25 is for
14 Delta.

15 Q Would you turn to page 24 of your testimony
16 in the Alt Reg Case? Just briefly, you state
17 at lines 13 and 14 that Delta is similar to
18 the five companies in your panel, don't you?

19 A Yes. And is similar in respect to the things
20 that I examined and it was as close as I
21 could find, of the 23 companies carried by
22 Value Line, to Delta.

23 Q In the process of sampling things to
24 determine similarities you are, I'm sure,

1 familiar with the concept of bracketing,
2 aren't you?

3 A Yes.

4 Q Which means that some of the samples are
5 higher and some are lower, right?

6 A Certainly.

7 Q Do the members of your panel bracket Delta?

8 A No, not entirely. In size, for example, the
9 companies tend to be larger than Delta. What
10 these companies are, companies that are
11 closest as I could find to Delta given the
12 criteria that I examined. The majority of
13 them are larger than Delta, they have more
14 equity in the capital structure, and there
15 are differences from Delta.

16 Q Well, let's look at that briefly, if you
17 would, Dr. Weaver. You sampled on the basis
18 of the following criteria, didn't you? You
19 total asset size?

20 A Yes.

21 Q Net sales to total assets?

22 A Yes.

23 Q Common equity ratio?

24 A Yes.

- 1 Q Total liabilities to total assets?
- 2 A That's one of them, yeah.
- 3 Q Debt to equity ratios?
- 4 A No, the growth and total assets, which was
- 5 the second one and you left that out.
- 6 Q Sales to fixed asset ratios?
- 7 A Yes. No, no, no, you left out the growth and
- 8 assets, you mentioned the sales to fixed
- 9 assets.
- 10 Q Okay, fair enough, I apologize. Are there
- 11 any of the five companies smaller than Delta
- 12 with regard to total assets?
- 13 A No.
- 14 Q As a matter of fact, the closest one is over
- 15 three times larger than Delta, isn't it?
- 16 A Over three times?
- 17 Q That's my recollection. Look at your
- 18 schedule one if you would please?
- 19 A Cascade is next smallest company, yes it is
- 20 102,000 versus 311,000, yes.
- 21 Q Are any of the five companies smaller than
- 22 Delta with regard to the ratio of net sales
- 23 to total assets?
- 24 A No.

1 Q Do any of the five companies have a lower
2 equity ratio than Delta?

3 A No.

4 Q Do any of the five companies have a higher
5 1996 to '98 average ratio of total
6 liabilities to total assets than Delta? I
7 know there is one equal, but I don't think
8 there is any higher, right?

9 A Right.

10 Q Do any of the five companies have a lower S&P
11 relative strength rank than Delta?

12 A No. Let me check that. As I indicated
13 earlier, these companies are as close to
14 Delta as I could find in the list of the 23
15 companies followed by Value Line.

16 Q Is it fair to say, then, that you agree with
17 Dr. Blake's testimony yesterday that there
18 aren't any companies similar to Delta for
19 comparability purposes?

20 A I don't think there are any two companies
21 that are clones of each other irrespective of
22 size, irrespective of sales to total assets
23 or any of the criteria. What you have to do
24 is find the closest to you can find and then

1 use that to sample your data in the cost of
2 capital determination. In the cost of
3 capital your Bluefield and Hope is an
4 important consideration and to consider
5 similar companies that have comparable risks.
6 This criteria examines that risk so it is
7 important to examine criteria on these
8 companies to find similar companies. Or
9 companies that are as close as you can find
10 as possible, which this is the better
11 descriptor of what happened here.

12 Q When you have a situation like the one that
13 exits with Delta in your panel, where they
14 really aren't similar, there is no bracket at
15 all, there is no above and below, all of your
16 panel companies have better performance
17 indicators than Delta; isn't that right?

18 A No, not necessarily. On cash flow analysis,
19 for example, which I consider to be extremely
20 important, Delta had the best cash flow
21 coverage of earnings.

22 Q What was in your cash flow calculation?

23 A Cash flow, I used the FASB '95 calculation of
24 cash flow and used cash flow from operating

1 activities which is included as using the
2 indirect methods where it is net income plus
3 depreciation, plus or minus all changes in
4 current liabilities and current assets except
5 cash and notes. And that would be cash flow
6 from operating activates, and then divide
7 that to get the cash flow coverage of net
8 income by net income, and get the number of
9 times coverage. And in this case we see that
10 Delta's quality of earnings measures 3.62
11 times, that is a two year average. The panel
12 companies averaged 1.96 times. So, Delta has
13 much better quality.

14 Q Dr. Weaver, you did not use the standard
15 times interest earned measures that are used
16 by analysts, did you?

17 A Yes. This is an analyst measure for cash
18 flow coverages from the FASB '95 statement.
19 Certainly, that is why the accounting
20 profession produces it is for analysts to
21 examine it.

22 Q When you have a situation, going back to the
23 take off point, when you have a situation in
24 which your panel of companies is not similar

1 to the subject company, isn't it necessary to
2 make, if you will, after the fact adjustments
3 to try to put them on the same footing or to
4 make them more comparable?

5 A Well, as I say, it is a judgement call and in
6 this case I did, I added 50 basis points to
7 the determined results for the panel of
8 companies to allow for that factor.

9 Q Do you still agree that that 50 additional
10 basis points is appropriate for Delta?

11 A Yes, I do.

12 Q Isn't this a somewhat subjective assessment
13 of risks when you added that on?

14 A Somewhat subjective, yes. But we can even
15 back into it using the 15 basis points per
16 percentage point difference in equity
17 criteria. When we look at equity to total
18 assets of Delta versus equity to total assets
19 of the panel companies, equity--the panel of
20 companies has 3.1% more equity than does
21 Delta. That is 3.1 percentage points, not
22 percent. So, if I take my 3.1 percentage
23 points times the 15 basis points, that is a
24 45 basis point adjustment. So, even though

1 it was subjective, the criteria works in any
2 number of ways.

3 Q Well, will you please turn to your response
4 to Delta's Data Request, Item 27?

5 A Yes.

6 Q Now, there you were talking about risk
7 reduction that result from implementation of
8 the ARP; correct?

9 A Yes.

10 Q And then you say that the assessment was
11 subjective?

12 A Yes.

13 Q But now you are saying that it is more than
14 subjective?

15 A No, this refers to the ARP.

16 Q Is it different risk?

17 A Yes.

18 Q You mean risk is a different subject if you are
19 talking about ARP than if you are talking about no
20 ARP?

21 A Absolutely.

22 Q Oh, I see.

23 A The--my recommendation was if the ARP is not
24 adopted, if the ARP was adopted the range

1 that I would recommend because Delta would be
2 more like a bond, the range would be from 8%
3 to 9%, in my opinion.

4 Q Did you account for the substantial
5 difference in the size between Delta and the
6 five companies on your panel when you
7 determined Delta's return on equity?

8 A I acknowledge there was a difference in size,
9 and there is a substantial difference in
10 size, I will agree with that. It is my
11 belief that that does not have a great effect
12 on the risk of the company once they achieve
13 a certain size, have stock outstanding, they
14 are publicly traded, carried on NASDAQ so
15 that you get wide dissemination of
16 information about the company, they are in
17 the Value Line expanded edition, not in the
18 normal edition but in the expanded edition
19 carried, so there is wide dissemination. I
20 think with the information revolution that we
21 are having today size is less of a factor in
22 determining risk of companies.

23 Q You mentioned a moment ago that Delta is
24 traded on the NASDAQ; correct?

1 A Yes.

2 Q Your five companies are New York Stock Exchange
3 companies, aren't they?

4 A Yes.

5 Q Did you hear Mr. Jennings testify yesterday about
6 the difficulties that he has had trying to
7 interest underwriters in placing equity securities
8 for the company?

9 A I heard him testify to that effect, yes.
10 But, and I found it sort of curious in a way,
11 the company--but it is mainly through a
12 dividend reinvestment plan and through ESOP
13 plan, the number of shares of outstanding in
14 this company have increased every year from
15 1991 through 1998. The book value of the
16 shares, the total book value, so when we not
17 look at just retained earnings but look at
18 the common equity, plus paid-in capital, plus
19 retained earnings, that value has increased
20 every year but in 1998. So, all but one year
21 in 1991 through 1998. So, yes, the company
22 has had financial problems, I will agree
23 there, and I think they are risky and I think
24 they need a rate increase. And I'm sure that

1 the company has had trouble with large issues
2 of common stock, but the fact is the common
3 stock outstanding has been growing, the total
4 common equity has been growing, and I feel
5 like that point was a little bit over
6 emphasized maybe. I don't feel it is as
7 dire--my belief is it is not as dire as it
8 sounded.

9 Q When the common stock grows, when the common
10 equity grows, when the number of shares
11 outstanding are growing, doesn't that mean
12 that it takes more money annually to cover a
13 dividend?

14 A Oh, absolutely.

15 Q And I believe that you are firmly in the camp
16 that stands for the proposition that a
17 company cannot go on and not earn its
18 dividend, aren't you?

19 A Yes.

20 Q And to the extent that Delta, through its
21 drip or whatever means, is increasing the
22 number of shares outstanding but has
23 inadequate revenues to cover those dividends,
24 it is exacerbated by things like increasing

1 shares outstanding when it does not have a
2 corresponding increase in the revenues
3 necessary to cover those dividends; isn't
4 that right?

5 A When that income is not increasing
6 sufficiently, of interest here--and, again,
7 it goes back to the cash flow and quality of
8 earnings, though. Of the panel of companies
9 Delta had the best cash flow coverage of
10 dividends of all five companies.

11 Q Going back to your panel and when you came up
12 with Delta's return on equity, did you
13 account for the substantial difference in
14 leverage between Delta and the five companies
15 in your panel?

16 A I acknowledge that Delta has more leverage.
17 As far as a return on equity, the return on
18 equity measures what it is and if the panel
19 has less leverage, and to the extent that
20 leverage affects their return on equity, that
21 would show up in any return comparison. So,
22 in an indirect way, yes, that is an automatic
23 occurrence.

24 Q Well, but you did not make an after the fact

1 adjustment that recognized that a substantial
2 difference in leverage between Delta and the
3 five panel companies, did you?

4 A Oh, yes, I added 50 basis points to my
5 overall results to account for that
6 difference.

7 Q Was that based on leverage?

8 A It is based on the difference in risk of which
9 leverage is a major part.

10 Q Is it true that the higher a company's
11 leverage is the more risky it is?

12 A Yes. But let's back up and let me explain
13 that, too, though. The risk is not the fact
14 that one company has more leverage or less
15 leverage that type thing, the risk comes
16 about because a company with more leverage is
17 really using more debt and it has got more
18 repayment obligations. And it is the cash
19 repayment obligations and the ability to make
20 those repayments and make any interest
21 payments on that, meet sinking fund payments,
22 that cause the risk. That's the source of
23 the risk, and that is why when you look at
24 risk differences look at the amount of total

1 equity to total assets or total liabilities
2 and preferred stock to total assets, and that
3 is where I got the 3.1% difference and found
4 that Delta, yes, it is more risky, a little
5 bit, but 3.1 percentage points more, not a
6 great deal, in my opinion.

7 Q Dr. Weaver, did you account for the difference in
8 risk resulting from three of your five panel
9 companies having a weather normalization mechanism
10 in place?

11 A That's reflected in the data and using market
12 data will automatically account for that. It
13 should be reflected in the prices, the
14 dividend yields, and the DCF models and also
15 in the capital asset price models that is
16 reflected in the betas.

17 Q So, you did not make an after the fact
18 adjustment for that; is that right?

19 A That's adjusted for in the--using capital
20 market data automatically, so no adjustment
21 is required.

22 Q Would you please refer to your response to
23 Delta Data Request, Item 28?

24 A I have it.

1 Q There you say that--and this, again, addresses our
2 panel companies--that CTG resources has weather
3 normalization insurance; correct?

4 A Yes.

5 Q Energen has a rate stabilization and
6 equalization mechanism; correct?

7 A Yes, that is Alabama Gas, Energen is the
8 parent holding company.

9 Q And it is included as those that has a
10 weather normalization?

11 A Uh-huh, yes.

12 Q South Jersey Industry has a temperature
13 adjustment clause; correct?

14 A That's correct.

15 Q Now, could you please explain to the
16 Commission how each of these mechanisms work?

17 A No, I couldn't.

18 Q So, you don't really know whether or not any
19 of them are like Delta's Alt Reg Plan except,
20 possibly, the Energen one, right?

21 A Well, even the Energen one appears to be
22 different in many parts and many points.

23 Q Do you think these three mechanisms would
24 have the affect of reducing the variability

1 in revenues and earned returns for these
2 three companies?

3 A Oh, absolutely. For example, Energen, the
4 Standard & Poor's stock report indicated that
5 Alabama Gas ROE has been constant over the
6 prior ten years. The problem that Energen
7 and the stock market has, and the reason the
8 market reflects its higher risk is that
9 Energen has an exploration and development
10 subsidiary. And they have been growing that
11 and so, the port folio effect of the high
12 risk venture and exploration and development
13 of oil reserves and gas reserves has been
14 offset by the mitigating circumstances of the
15 company, so that the portfolio effect on the
16 dividend yield and price of the stock has
17 made it look like every other gas company.

18 Q Since the three mechanisms result in a
19 reduction in the variability of earned
20 returns for these companies, would it be fair
21 to say that the majority of your five company
22 panel have in place a mechanism that reduces
23 the variability of their revenues and earned
24 income and that Delta does not have such a

1 mechanism in place?

2 A I'll agree that Delta does not have a
3 mechanism in place. The New Jersey
4 mechanism, according to Value Line write up,
5 has not been successful but it is being
6 changed. Prior to that write up it was
7 changed, I think, in 1998, in that calendar
8 year, to try to make it work better. So,
9 with that exception, yes, they should be more
10 stable.

11 Q How did you quantify the difference in risk
12 between Delta and your five company panel
13 that results from the majority of the panel
14 having in place a mechanism that reduces the
15 variability of their revenues and earned
16 returns?

17 A I quantified the risk looking at the cash
18 flow coverages. I looked at the published
19 risk measures from Value Line and Standard &
20 Poor's. I looked at the other standard risk
21 measures that we have discussed here.

22 Q Did you take into account any place in your
23 determination of Delta's return on equity the
24 additional risk factor that Delta has over

1 the majority of your panel by virtue of
2 Delta's not having in place these
3 stabilization plans that the majority has?
4 A No, I did not. There is a very good reason
5 for that and I explain this pretty carefully
6 back in the appendix to my testimony where I
7 explained that it is total risk that is
8 important to the company because that is what
9 the market faces, not the risk from any one
10 source because the companies are different.
11 And the companies in a panel or in a group
12 will have risks from sources that are
13 different from the other companies, but it is
14 the total risk that must be considered. So,
15 in this case we look at measures of total
16 risk to account for risk differences.

17 Q Given what you just said, Dr. Weaver, why is
18 it you are recommending such a large
19 reduction in Delta's return on equity by
20 virtue of the Commission's adoption of its
21 Alt Reg Plan?

22 A Like I mentioned earlier, the Alt Reg Plan,
23 while it doesn't 100% guarantee the rate of
24 return will be earned because you have a band

1 about the authorized rate of return and you
2 do have inflation caps on expenses and
3 things, it pretty much comes close to
4 guaranteeing the return will be earned. With
5 that in mind, then, Delta's stock will be
6 more like a bond than as shares of common
7 stock. Its risk will be greatly reduced and,
8 therefore, its return should be lower because
9 it has much lower risk. In 1998 Delta issued
10 a bond and the yield on that bond at issue,
11 this is yield after price discount and
12 issuing expenses, was 7.6%. So, and that
13 bond also reflects Delta's risk because it is
14 an obligation of Delta's. That was a big
15 factor in causing the 8% to 9%
16 recommendation.

17 Q I've almost forgotten where I was with your
18 digressions, Dr. Weaver, --

19 A I'm sorry.

20 Q --but let me see if I can get back on track here.
21 The five company panel, three of which have some
22 sort of stabilization mechanism, have an average
23 return on equity of 9.75 to 10.75; right?

24 A Cost of equity, right.

1 Q I think we established that earlier. Now,
2 you say however that if Delta gets one of
3 these plans, that is, it's Alt Reg Plan, the
4 equity ought to be reduced to 8% to 9%; is
5 that right?

6 A That's correct.

7 Q Now, Alagasco, which is one of the panels,
8 one of the companies on your panel, has the
9 rate stabilization and equalization plan and
10 a weather norm plan; correct?

11 A The--as I indicated earlier, I haven't
12 studied their plans, but my guess is, you
13 know, that if you have the Alt Reg Plan you
14 don't need a weather normalization, that is
15 taken care of in the plan. But its earnings
16 have been stable, yes.

17 Q Dr. Weaver, you know that the range that the
18 Alabama Commission has approved for
19 Alagasco's return on equity is 13.15 on the
20 low side to 13.65 on the high side with a mid
21 point of 13.4%; you know that, don't you?

22 A I have heard that here. I have not seen the
23 order or I have not done a cost of capital
24 analysis of Alagasco. I have no idea why

1 they are allowing that return.

2 Q You quoted Bluefield in your direct testimony
3 and you just mentioned it a moment ago.

4 A Yes.

5 Q And if you look on page six of your Alt Reg
6 testimony you say--and this is about in the
7 middle of the quote from Bluefield--"The
8 return to the equity owner should be
9 commensurate with the return on investments
10 and other enterprises having corresponding
11 risks," do you see that famous sentence out
12 of Bluefield?

13 A Yes.

14 Q We have all read it a million times, haven't
15 we?

16 A And written it a million times when you do
17 this.

18 Q Shouldn't Delta's return, with the use of the
19 Alt Reg Plan and weather normalization,
20 therefore be commiserate with Alagasco's
21 return of 13.15 to 13.65%, applying
22 Bluefield?

23 A Well, as I indicated, Alagasco is one of the
24 subsidiary companies in Energen. They also

1 have an exploration and development
2 subsidiary that mitigates that risk affect
3 considerably. And, therefore, their cost of
4 equity, it might be high, the reason for the
5 13.1 is they did a market evaluation of the
6 cost of equity and found that they were high
7 risk due to the business activity of the
8 exploration and development subsidiary.

9 Q Well, now, the exploration and development
10 subsidiary is not relevant--regulated by the
11 Alabama Commission, is it?

12 A It shouldn't be but they could have been
13 taken into consideration, may not have been,
14 I don't know what was considered when they
15 found that 13.1%.

16 Q Well, you just don't--in your Alt Reg
17 testimony on page 22, that is where you talk
18 about the S&P beta for Delta of 0.02; right?

19 A Right.

20 Q You have a familiarity with statistical
21 methods, don't you?

22 A Yes.

23 Q Do you know how the beta is reported in Value
24 Line and the S&P reports are estimated?

1 A Sure. The--both companies have a similar
2 method in that both Value Line and S&P use
3 the prior five years of data. Value Line
4 uses weekly closing prices, Standard and
5 Poor's uses monthly closing prices. So,
6 Standard and Poor's has a few less
7 observations than Value Line. Value Line
8 runs a regression on using the independent
9 variables of the New York stock exchange
10 index for similar observations, Standard &
11 Poor's uses the, believe or not, S&P 500 for
12 their index. Standard & Poor's does an
13 adjustment to their results--excuse me, I've
14 got it backwards. Value Line does an
15 adjustment, abasion statistical adjustment,
16 to their final results, whereas, Value
17 Line(sic) reports the raw regression
18 coefficient. So, .02 would be a raw
19 regression coefficient done by Standard &
20 Poor's prior five years data, monthly prices.

21 Q If a--well--a linear regression algorithm
22 from a standard statistical package such as
23 SAS, SPSS, or TSP will produce parameter
24 estimates even if there is no underlying

1 linear relationship, isn't that right?

2 A Sure. That's why you test to see if it
3 significantly different from zero, that type
4 of thing.

5 Q Uh-huh. And if a linear regression were
6 applied to a random set of data involving two
7 variables with X as the independent variable
8 and Y as the dependent variable, wouldn't the
9 parameter estimate associated with the X
10 variable be zero?

11 A It may not be since they--it depends on the
12 size of the set. If it is truly a random
13 data set for both variables and you've got a
14 large enough sample, yes, it should. You get
15 smaller samples you may get some bias one way
16 or the other and not hit--you should have a
17 number close to zero, though.

18 Q If there were an upward or downward slope
19 there would be some underlying pattern to the
20 data, right?

21 A Right.

22 Q And that is why the null hypothesis of B
23 equals zero is used in T-tests for assessing
24 the goodness of fit for parameter estimates?

1 A The--no, that's to whether or not you have a
2 relationship rather than goodness of fit.
3 You test to see whether there is any slope or
4 not, if B is equal to zero, you know, is not
5 significantly different from zero, then you
6 don't have a relationship.

7 Q Would you regard 0.02 as being close to zero?

8 A Oh, I sure would. That's why when I did my
9 CAPM analysis I just used the beta from my
10 panel of five companies and did not use beta,
11 this particular beta, because it is
12 ridiculously low and I doubt a relationship
13 does exist.

14 Q For once you got to the bottom line of my
15 question before I did, Doctor.

16 A Sorry.

17 Q Thank you, sir.

18 A I should do it more often.

19 Q You know, don't you, that the return that you
20 are recommending for Delta, if it adopts the
21 Alt Reg Plan, is not going to be sufficient
22 to cover its dividend?

23 A I haven't done a study on whether it would
24 not.

- 1 Q Well, let's see if we can walk through some
2 numbers to see whether or not you agree with
3 our assessment of that conclusion.
- 4 A Sure.
- 5 Q Subject to check, would you agree that Delta had
6 2,394,633 shares of common outstanding at the end
7 of the test year?
- 8 A Yes.
- 9 Q Would you agree that Delta paid an annual
10 dividend of \$1.14--
- 11 A Yes.
- 12 Q --for the test year? At a dividend of \$1.14
13 I think the arithmetic shows that it is going
14 to require \$2,729,882 of earnings to pay
15 everybody their dividend, would you accept
16 that?
- 17 A Sure.
- 18 Q At the end of the test year Delta had an
19 equity component of 28,351,812; correct?
- 20 A That sounds true.
- 21 Q Now, if you divide the total dividends of
22 2,729,882 by the test year end equity of
23 28,394,633--
- 24 A You need to go the other way, we are dividing

1 net income into the number of shares. We
2 need to divide the number of shares into the
3 earnings.

4 Q What I'm doing is I'm dividing the equity into the
5 amount required to pay the dividend.

6 A Oh, to get the equity per share, you are
7 going down to a per share on that, okay.

8 Q And that comes up with 9.6%; correct?

9 A I'll accept that.

10 Q And you are recommending a dividend--excuse me--a
11 rate of return of 8% to 9%, right?

12 A Yes.

13 Q I think you said earlier that no company can
14 continue and not earn their dividend; didn't you?

15 A I did say that and will continue to say that.

16 Q You agree, don't you, that lower earnings
17 result in a higher cost of equity and in
18 higher risk?

19 A Depends on the risk of those earnings. Lower
20 earnings on treasury bills, and treasury
21 bills are riskless investments. And there is
22 a risk return trade off, the higher the risk,
23 the higher the earnings; the lower the risk,
24 the lower the earnings. So, the risk return

1 line is upward sloping to the right, that is
2 why if an Alt Reg is adopted Delta will
3 have--it has much less risk, consequently, it
4 should have a much lower cost of equity.

5 Q Dr. Weaver, the last time I cross-examined
6 you was in 1997, the last time Delta was here
7 for its rate case, and the hearing was held
8 on September 9, 1997, and I asked you this
9 question and see if you remember giving this
10 answer. "I take it the converse of your
11 statement at lines 15 through 17 is also
12 true; that is, that lower earnings result in
13 a higher cost of equity and in a higher risk;
14 correct?" Answer: "Sure." We didn't get the
15 qualification there; correct?

16 A Yes. The qualification--I mean, I still
17 agree that if a company stays in the same
18 risk class, if risk doesn't change, if the
19 company persists in having lower earnings and
20 higher risk it is going to affect the cost of
21 equity so, yes, I'll stand behind that
22 statement also.

23 Q There were some suggestions in some of the
24 answers to data requests submitted by the

1 Attorney General's witnesses that the
2 leverage that Delta finds itself with, or its
3 capital structure, if you will, is somehow a
4 matter of choice. You have seen that haven't
5 you?

6 A Oh, I think I was one of the people that made
7 those kinds of comments, yes.

8 Q Don't you agree that it is not logical to
9 conclude that Delta would choose to let its
10 equity erode to the level at which it is
11 currently situated?

12 A In a rate case it certainly wouldn't.

13 Q Well, in real life it wouldn't either, would
14 it, Dr. Weaver?

15 A I think they should take steps--I questioned,
16 for example, in my testimony why the dividend
17 was increased when it was, when the equity
18 was eroding. Things of that nature,
19 management in other companies when they get
20 into a drastic situation have even been known
21 to cut a dividend, which is really a drastic
22 action, and that increases capital cost rates
23 tremendously. But it can happen and it
24 preserves that equity cushion against risk.

1 Q Don't you agree that Delta's stated desire to
2 increase its return on equity and sell more
3 stock does not indicate that it wants to
4 reduce its equity and increase its debt?

5 A I'm sorry, could you repeat the question?

6 Q Sure.

7 A It didn't--it kind of went over my head.

8 Q Well, Delta is here asking this Commission to
9 approve a higher return on equity so that it
10 can go out and sell more stock. You heard
11 Mr. Jennings say that, didn't you?

12 A I heard him say that they needed a higher
13 return on equity. I'm not sure I heard the
14 "so that they could go out and sell more
15 stock." I did not know an equity sale was
16 imminent after this case. In fact, Mr. Hall,
17 one of the reasons I made the flotation cost
18 adjustment I did was Mr. Hall, in his
19 testimony, stated that there are no plans for
20 any capital market issues through 2001, I
21 believe, or 2000 maybe. But he indicated the
22 company has no plans for new capital market
23 issues.

24 Q Rather than debate you about what we recall

1 of Mr. Jennings' testimony, just take it from
2 me the company would like to be able to sell
3 equity so that it can improve its capital
4 structure, if that is the case, Dr. Weaver?

5 A Oh, and I'm sure--

6 Q Wouldn't you agree that it is not logical to
7 conclude with that desire that it wants a
8 highly leveraged capital structure like it
9 currently has? That it is not a matter of
10 choice?

11 A I'm not following the question. If they are
12 to have a new equity sale they would need
13 rate relief prior to that. Does that provide
14 a response?

15 Q Not really, but I'm not sure that I want to
16 go much further with it Dr. Weaver. You have
17 worn me out, to tell you the truth.

18 CHAIRMAN HELTON:

19 Mr. Watt, unless you are really close to
20 concluding with this witness we are
21 going to take our break now.

22 MR. WATT:

23 I'll probably have another 15--10 or 15
24 minutes, so we probably ought to.

1 CHAIRMAN HELTON:

2 Yes, I think we need to take a break.

3 (OFF THE RECORD)

4 CHAIRMAN HELTON:

5 Mr. Watt, continue.

6 Q Dr. Weaver, in your response to Delta's Data
7 Request, Item 22, you said that you had
8 recommended the use of a hypothetical capital
9 structure in situations where the applicant's
10 capital structure was different from a typical
11 capital structure for an industry; remember that?

12 A Yes.

13 Q When you made that statement, did you intend
14 to use the phrase hypothetical capital
15 structure as about the same as imputed
16 capital structure?

17 A No. What--and I'm fuzzy on it, this was when
18 I was with the Virginia Commission, head of
19 the Economic Research and Development
20 Division, and in several cases, at least one
21 case, I know I recommended using a
22 consolidated capital structure for a
23 subsidiary rather than the subsidiary capital
24 structure. And I may have done that, I think

1 I--I think I did it in an Appalachian Power
2 Case, I'm not positive. I also think it
3 could have happened in a Virginia Carolina
4 Telephone Case that I testified in. It was--
5 I think I did a few times but I can't
6 remember the specifics.

7 Q Well--

8 A But in every case it would have been a
9 consolidated company capital structure when a
10 subsidiary was in for a rate case.

11 Q You might ought have lost track of my
12 question there. What I was trying to find
13 out was whether or not you used the term
14 hypothetical capital structure either to be
15 equal to or to include the term imputed
16 capital structure?

17 A No, I interpreted it as something other than
18 the actual capital structure. And the only
19 time I've done testimony it has either been
20 the actual capital structure or the
21 consolidated capital structure, and I use
22 hypothetical and impute in the same way, yes,
23 if that is the question.

24 Q That was the question, yes. Delta's equity

1 component of about 30% is much smaller than
2 the 46% plus or minus average--

3 A That's total capitalization, what the market
4 really is concerned with is total assets
5 because--

6 CHAIRMAN HELTON:

7 Mr. Weaver, I don't believe he finished
8 his question.

9 A Oh, excuse me.

10 MR. WATT:

11 Thank you, Your Honor.

12 A I'm sorry, I apologize.

13 Q Delta's equity component of about 30% is much
14 smaller than the approximate 46% average of
15 your panel of five companies; correct?

16 A I disagree.

17 Q Well, that's about what the numbers are,
18 isn't it?

19 A That's equity to total capital as opposed to
20 equity to total assets. And the difference
21 between equity and total assets is the
22 liabilities which have the repayment
23 obligation. That's the source of risk.

24 Q Don't you agree, Dr. Weaver, that Delta is

1 different from your so-called comparable
2 companies in your panel?

3 A Yes.

4 Q And in that situation you fall into the
5 circumstance, which you described in answer
6 to Item 22, that a hypothetical capital
7 structure might be different if the company's
8 capital structure was different from a
9 typical capital structure for an industry;
10 isn't that right?

11 A Yes.

12 Q In response to Delta's Data Request, Item 31,
13 you were kind enough to submit to us a copy
14 of the article which you wrote for Public
15 Utilities Fortnightly in the September 4,
16 1986, issue; do you remember that?

17 A Yes.

18 Q In the summary portion of that article on
19 page 23 you wrote: "If a utility company
20 fails to maintain the leverage component in
21 its capital structure, hypothetical capital
22 structures might be imposed in regulatory
23 proceedings." Isn't that right?

24 A That's correct.

1 Q You also said in that article at the bottom
2 of page 22, going over to page 23: "Increased
3 dividend payment amounts will stimulate the
4 demand for utility common stocks and result
5 in higher market price to book value ratios.
6 This will serve to reduce the cost of equity
7 capital. In addition, it should make equity
8 financing easier to accomplish in the
9 future." You wrote that, didn't you?

10 A Yes.

11 Q You believe that that is true, don't you?

12 A Yes.

13 Q I want to ask you a question or two on this
14 cash flow analysis that you did that you
15 talked about just right before we broke; you
16 remember that? You are aware, aren't you,
17 that when you perform the cash flow analysis
18 under FASB '95 or '96, whichever it is, you
19 can include short-term debt in that?

20 A Short-term is a financing activity. That's
21 included down in cash flow from financing
22 activities.

23 Q Wasn't short-term debt included in the cash
24 flow that you utilized to come up with the

1 numbers that you used?

2 A Oh, for cash flow coverage of interest?

3 Q Yes.

4 A To get cash flow from operating activities,
5 before the interest payment, you add the
6 interest back and then divide by interest so
7 that you get a cash flow from operating
8 activity before interest, divided by
9 interest, it gives you a true coverage.

10 Q The cash flow that you utilized included
11 Delta's short-term debt, didn't it? That is
12 advances from its short-term line of debt?

13 A The cash flow from operating activities that
14 I used was a cash flow constructed by the
15 indirect method and it include--it excluded
16 the change in short-term debt. The change in
17 short-debt is a financing activity, and there
18 are three categories on the cash flow
19 statement, cash flow from operating
20 activities, cash flow for investing
21 activities and cash flow from financing
22 activities. Debt is a financing activity,
23 the cash flow I use is cash flow from
24 operating activities.

1 Q Is it your testimony today that when you
2 perform the cash flow analysis that you
3 described earlier and that you have described
4 in your direct testimony that there were no
5 funds resulting from Delta's short-term line
6 of credit included in that cash flow? Is
7 that what your testimony is Dr. Weaver?

8 A Cash flow from operating activities excludes
9 short-term debt changes, that is my
10 testimony.

11 Q Okay. Let me ask you about your cash flow
12 analysis, the one you did for Delta in this
13 case. Is it your testimony that there were
14 no funds from Delta's short-term line of
15 credit included in the cash flow that you
16 utilized in that calculation?

17 A To my knowledge, there is not.

18 Q If there had been, then any sort of positive
19 that you would attribute to the short-term
20 numbers, the good short-term coverage you
21 were talking about, would really be a
22 negative because it would be racing more
23 rapidly toward the need to finance to take
24 that short-term debt out; correct?

1 A The good coverage is wherein cash flow
2 coverage of net income, which is a quality of
3 earnings measure, and cash flow coverage of
4 dividends, in both of those cases you leave
5 interest expense out and interest should not
6 be included.

7 Q Dr. Weaver, you know how we asked you about
8 how you did this analysis in the data
9 request, and I apologize because I don't
10 remember which one, but you gave an answer
11 that said that the analysis, you didn't have
12 any work papers, but the analysis was on a
13 Lotus spread sheet, it is Item 36 if you
14 would turn to it.

15 A I have it.

16 Q You see the last sentence of your response,
17 the cash flow schedules were done on Lotus
18 spread sheets?

19 A Yes.

20 Q But you didn't send us either a disk or the spread
21 sheets when we asked you to give us work papers on
22 that, did you?

23 A No, I didn't have any physical pieces of
24 paper or anything.

- 1 Q What happened to the Lotus spread sheet?
- 2 A I have in a file somewhere, I do have the
- 3 Lotus spread sheets.
- 4 Q Okay. But you didn't send those to us right?
- 5 A No.
- 6 Q I guess they probably would have shown what
- 7 the elements of your cash flow analysis were,
- 8 wouldn't they?
- 9 A No, I took the--simply I took the company's
- 10 cash flow statement and copied cash flow from
- 11 operating activities as reported by the
- 12 company, as the cash flow that you would see,
- 13 for example, on--for Delta, for example, it
- 14 would be in Schedule 13. And Schedule 13 you
- 15 see cash flow from operating activities for
- 16 1997, 1998--
- 17 Q Which testimony?
- 18 A Huh--that would be the 99-046.
- 19 Q Which schedule?
- 20 A Schedule 13. And that is taken straight off
- 21 of the company's statement. I didn't go back
- 22 and reconstruct it because it was already
- 23 there.
- 24 Q The third line down on your Schedule 13.

1 A That's cash flow from financing activity.

2 Q Uh-huh. You used that in your cash flow
3 analysis?

4 A No, I as I indicated in my direct testimony
5 what the numerators and denominators are for
6 these coverage ratios. Cash flow coverage of
7 interest is cash flow from operating
8 activities, which is the first line, plus
9 interest, divided by interest. Cash flow
10 coverage of dividends, this is cash flow from
11 operating activities divided by total
12 dividend. Cash flow coverage of investing
13 activities is cash flow coverage of operating
14 activities divided by total cash flow from
15 investing activities, and you usually do a
16 sign change, make it a minus sign because
17 investment activities are cash outflow. So,
18 it appears as a negative number. Quality of
19 earnings is cash flow from operating
20 activities divided by earning--total earnings
21 available for common which is normally what
22 is net income.

23 Q Going back to your Lotus spread sheet.

24 A Yes.

1 Q I guess you could have printed that, couldn't
2 you?

3 A Sure.

4 Q Or you could have sent the disk?

5 A I didn't think it was necessary because this is
6 what it was. The only thing the Lotus did was it
7 did the division.

8 Q When you first--in fact, it is part of your
9 direct examination, I guess, you did some
10 corrections to your direct testimony;
11 remember that?

12 A Yes.

13 Q Where you changed the reference to the nine
14 companies to five?

15 A Uh-huh.

16 Q I assume the five were your five company
17 panel; is that right?

18 A That's right.

19 Q If you would just go ahead and turn to page 20 of
20 your testimony.

21 A The 046?

22 Q I think that is 046, I think you only changed that
23 to about what, 25 or so, right?

24 A Uh-huh, 046. I have it.

1 Q At lines 19 and 20 I believe you state Delta's
2 coverage measured 3.62 times while the coverage
3 measure for the nine, changed to five, averages
4 1.96 times, right?

5 A That's correct.

6 Q Then you went on to say in lines 11 to 13
7 Delta with a lower coverage has a greater
8 likelihood of having to perform external
9 equity financing than the nine, changed to
10 five, companies; did I read that right?

11 A Yes.

12 Q With Delta having a greater likelihood of
13 having to perform external equity financing,
14 won't Delta have a difficult time placing
15 this additional equity since it has not
16 generated sufficient earnings to cover its
17 dividend in four of the last five years?

18 A Yes.

19 Q You heard Dr. Blake yesterday when he
20 testified about Delta having a problem
21 getting a financial institution to offer--to
22 purchase their equity; remember that?

23 A Yes.

24 Q Do you have any suggestions about how or

1 where Delta could place additional equity?

2 A Well, while he was stating that I noticed they
3 have a--what appears to be--have been an equity
4 issue in 1997 when the number of shares
5 outstanding went from 1,900,000 up to 2,340,000,
6 according to this source. I would say the same
7 source, if possible.

8 Q Well, do you remember when Mr. Jennings was
9 testifying about that, that was Edward D.
10 Jones, and he said Edward D. Jones is not
11 interested given the state of the earnings.

12 A I don't believe he mentioned by name.

13 Q I think that is who it was and I think that
14 is what he said, so given the fact that
15 Delta's earnings has caused Edward D. Jones
16 to have a lack of interest, do you have any
17 other suggestions?

18 A The only suggestion I would have is contact
19 investment bankers, they make their living by
20 being the intermediary between companies and
21 the capital market, and in a competitive
22 market like we have I would feel certain
23 there would be companies out there that would
24 accept the business. They may require a

1 higher cost rate, it may require additional
2 flotation costs, and it may require
3 additional under pricing that occurs, but
4 they are out there.

5 Q Would you please turn to page 38 of your Alt
6 Reg testimony?

7 A I have it.

8 Q Specifically, line five, you found that the
9 five companies in your panel were less risky
10 than Delta, you see that testimony, don't
11 you?

12 A Yes.

13 Q Since Delta is riskier than those companies--
14 well, let me back up a second. Isn't it
15 correct that when you were doing your CAPM
16 analysis you used the beta for those five
17 companies as opposed to the beta for Delta or
18 for something else?

19 A That's correct.

20 Q Since Delta is riskier than those companies,
21 wouldn't it be appropriate to use a higher
22 beta than the .6 for those companies?

23 A Not necessarily, because here I'm talking
24 about total risk not systematic risk. Beta

1 is a measure of systematic risk; that is, the
2 change in stock price relative to the change
3 in the market. And we saw from the
4 previously discussed beta co-efficient that
5 in a regression analysis it showed that
6 Delta's price movement is almost independent
7 of the market. That would tend to indicate
8 that it has very little systematic risk, so
9 from that perspective Delta perhaps has less
10 systematic risk, which is the risk that has
11 the risk premium associated with it than does
12 the five companies.

13 Q Instead of doing a CAPM analysis for the five
14 companies, why didn't you do one for just
15 Delta using this beta that you told us about
16 yesterday from Value Line?

17 A I looked at the five companies, I used the
18 panel of five companies in the DCF analysis,
19 I used them in the CAPM analysis and I also
20 used them in the bond yield risk premium
21 analysis as the primary source. Delta's
22 return should be similar to companies that
23 have comparable risk. It is required that
24 you look at similar companies, and as similar

1 as you can make them, and then I adjusted for
2 my perceived difference in the risk level.

3 Q You said in your original direct testimony ,I
4 think it was in the Alt Reg case on page 22,
5 Delta is not covered by Value Line; remember
6 that testimony?

7 A In their primary series they are not. Delta
8 is covered in the extended series of
9 coverage.

10 Q Do you remember when Delta requested you in a
11 data request, I think it is Item 37, to send
12 all the documents that you had containing or
13 reflecting data--Delta's beta?

14 A And I did not have this document at that
15 time.

16 Q When did you get it?

17 A I got it on Wednesday morning before I came
18 up here.

19 Q Did the document not exist before Wednesday
20 or you just hadn't found it before Wednesday?

21 A It existed but I hadn't found it.

22 MR. WATT:

23 That's all the questions I have Your
24 Honor. Thank you Dr. Weaver.

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CROSS EXAMINATION

BY MR. WUETCHER:

Q Good afternoon Dr. Weaver.

A Good afternoon.

Q Do you accept Delta's proposed debt cost of 5.41% for short-term debt and 7.48% for long-term debt?

A Yes, I did.

Q Okay. Could you tell us what caused you to change your recommended debt cost?

A I did a yield maturity analysis on the long-term debt cost and actually my range came out a little higher than theirs, and if that is the request that they wish, I'll accept that lower request.

Q Based upon your revised Schedule 34 to your testimony filed on September 23, 1999, I believe that is the testimony in the rate adjustment case, is it correct to conclude that you are also accepting Delta's historical capital structure as adjusted? And I'm not referring now to their hypothetical capital structure but just their

1 historical capital structure?

2 A Yes, I am.

3 Q Okay. Can you tell us why you changed your
4 recommended capital structure?

5 A I'm not sure I did change the capital
6 structure. Let me check.

7 Q Okay.

8 A The capital structure in Schedule 99-046 is a
9 fiscal year end, September year end capital
10 structure, and in the subsequent filing they made
11 it a December 31 capital structure, so the
12 structure changed.

13 Q Okay, thank you. What is your opinion of Dr.
14 Blake's recommendation that the Commission
15 use a hypothetical capital structure to
16 determined the required rate of return?

17 A I recommend that it not be adopted.

18 Q Okay. Assume for the moment that the
19 Commission didn't accept your recommendation
20 and chose instead to use a hypothetical
21 capital structure, what would you recommend
22 in terms of required return on equity?

23 A As we increase the amount of equity in a
24 capital structure, there will be a reduction

1 in risk and some reduction in the amount of
2 the cost of capital there. What capital
3 structure was the Commission considering? I
4 know I can't ask a question, if the
5 Commission was considering, say, going to a
6 40% capital structure, I would recommend
7 probably about a .75 to 1% reduction in the
8 cost of equity. But I would--I'd like to,
9 rather than answer from here, look at the
10 capital asset pricing model risk premiums,
11 look at the bond yield risk premiums to get
12 information and see how that might be
13 affected with the comparable companies or the
14 similar companies that I have to--before I
15 made a final number estimate of how that
16 would affect the recommendation.

17 Q Well, to the extent of the assumption you
18 have just used, if you could go ahead and
19 provide us then with any clarifications on
20 that. When you updated your testimony on
21 September 23, several of your calculations of
22 the cost of equity increased. Why did you
23 not update your recommended return on equity?

24 A Because the return on equity that I made

1 originally on the--and presented in the July
2 30 testimony was a future oriented range
3 using projected data. The capital cost rates
4 and the interest rates have risen over the
5 period and--however, the projected data that
6 I used accounted for that rise in my
7 recommendations still exceeded, in instances,
8 or were higher than what those rates are
9 today. So, the--was no reason to change the
10 recommendation. Those rates rising were
11 anticipated in the data I was using.

12 MR. WUETCHER:

13 That's all we have. Thank you Dr.
14 Weaver.

15 CHAIRMAN HELTON:

16 Ms. Blackford, do you have any redirect?

17 MS. BLACKFORD:

18 No.

19 CHAIRMAN HELTON:

20 Mr. Watt?

21 MR. WATT:

22 No.

23 CHAIRMAN HELTON:

24 You may be excused.

1 MS. BLACKFORD:

2 Call Mr. Galligan.

3 (WITNESS DULY SWORN)

4

5 The witness, RICHARD GALLIGAN, having first been
6 duly sworn, testified as follows:

7 DIRECT EXAMINATION

8 BY MR. BLACKFORD:

9 Q Mr. Galligan, would you state your name and
10 business address for the record please?

11 A My name is Richard Galligan, my business address
12 is Exter Associates, Incorporated, 12510
13 Prosperity Drive, Suite 350, Silver Spring,
14 Maryland.

15 Q Are you the same Richard Galligan who caused
16 to be filed certain testimony in Case Number
17 99-176 on behalf of the Attorney General on
18 September 23 of this year?

19 A Yes, I am.

20 Q Do you have any corrections or amendments to make
21 to that testimony?

22 A I do have two changes on page 16. One is on
23 the question on line 16, I would strike the
24 word "unitized," and the second is on line 19

1 starting the answer, again, strike the word
2 "unitized."

3 MR. WATT:

4 Mr. Galligan, could I have the page
5 number please?

6 A Yes, page 16.

7 MR. WATT:

8 I'm sorry, I was on page 15. Can we
9 start over, I apologize.

10 A Yes. On line 16 in the question strike the
11 word "unitize," and similarly on line 19 in
12 the answer strike the word "unitize," and
13 with those changes the footnote becomes
14 unnecessary.

15 MR. WATT:

16 So, you want to delete that?

17 A Yes.

18 Q Are there any further corrections or amendments?

19 A No.

20 Q With those changes were I to ask you the same
21 questions today that are posed in that
22 testimony, would the answers that you would
23 give be the same?

24 A Yes, they would.

1 MS. BLACKFORD:

2 I move his testimony into the record and
3 hold the witness available for cross.

4 CHAIRMAN HELTON:

5 So ordered, Mr. Watt.

6 MR. WATT:

7 Thank you, Your Honor.

8

9

CROSS EXAMINATION

10 BY MR. WATT:

11 Q Mr. Galligan, would you--first, good afternoon.

12 A Good afternoon Mr. Watt.

13 Q Would you please turn to page 14 of your
14 testimony?

15 A Yes.

16 Q On lines 22 through 24 you state that your
17 cost of service study allocates 50% of
18 Delta's distribution mains cost on peak
19 demand and 50% on annual usage; correct?

20 A Yes, it does and in a footnote on page ten I
21 explain that an allocation on annual usage is
22 identical to an allocation on average demand.

23 Q Are you aware of any gas rate cases where the
24 methodology you are proposing was adopted by

1 this Commission?

2 A By this Commission, no, it has been adopted
3 in other jurisdictions, but my reading of the
4 history in this jurisdiction is that since
5 Administrative Case 297 there have been
6 several companies that have gone through two
7 rate cases and from what I read in those rate
8 cases the companies have not presented this
9 method. Some parties have--in one case it
10 was suggested that perhaps an averaging peak
11 method should be utilized but the Commission
12 found that no cost of service study, in fact,
13 had been performed. And it was proposed with
14 comments like, well, a rule of thumb might
15 suggest that was reasonable and so forth, and
16 then the Commission did not find a record
17 basis to adopt it. So, while the Commission
18 has encouraged, if you look at those orders,
19 has encouraged the moving away from reliance
20 on peak demands for the stated reason that
21 they feel that unreasonably and unfairly
22 allocates too much capacity cost or demand
23 related cost to residential customers, they
24 have not yet, to my knowledge, in this

1 jurisdiction, approved an average in peak
2 study.

3 Q You are aware, aren't you, that Delta's cost
4 of service approach, including the zero
5 intercept methodology for classifying
6 distribution mains, has been approved by this
7 Commission on several occasions?

8 A As I say, with a history of little support
9 for alternative rate studies, that is my
10 understanding, yes.

11 Q In Case 90-158 I believe the Commission said
12 the methodology is acceptable and should be
13 used as the starting point for gas rate
14 design, you don't dispute that, do you?

15 A Well, I don't have that exact language in
16 front of me, but I did see some similar
17 language where the Commission indicated that
18 it would use the study as a guide,
19 particularly where no other alternative was
20 available.

21 Q Well, in Case Number 10064 the Commission
22 likewise approved the methodology by saying
23 it provides an adequate starting point for
24 rate design and should be used as the guide

1 for the allocation of revenues to the
2 customer classes. You don't dispute that I'm
3 reading that correctly, do you?

4 A What company was that?

5 Q LG&E.

6 A LG&E. Could you point me to the page
7 reference?

8 Q I don't have the pages, it is the Order in
9 Case 10064, though.

10 A And what was the quote?

11 Q The methodology similar to the one used by
12 Delta "provides an adequate starting point
13 for rate design and should be used as the
14 guide for the allocation of revenues to the
15 customer classes."

16 A I don't have that exact language but that is
17 a study where the Commission, for example,
18 concluded that the AG has provided no
19 evidence to support the reasonableness of his
20 cost of service allocation methodologies, in
21 fact, when asked to explain the basis for one
22 of his proposed methodologies the AG's
23 witness vaguely characterized it as a rule of
24 thumb and reasonable at first glance.

1 Explanation such as that hardly support the
2 reasonableness of the AG's recommended
3 allocation methodology. So, in a case where
4 the Commission appears to have been provided
5 with no alternatives, it may well have
6 concluded that it was going to use the
7 company study as the starting point.

8 Q Would you characterize a 50/50 allocation as
9 a rule of thumb?

10 A No, as I explain in my testimony that is a very
11 conservative movement toward the reflection of
12 volumes in the allocation of distribution plant.

13 Q Did you perform any sort of empirical or
14 otherwise analysis to determine that the
15 50/50 allocation methodology is the
16 appropriate one?

17 A The basis of that is explained in my
18 testimony at pages 10 through 15, including
19 footnotes and in a data response. Due to the
20 mathematics of the through-put when you
21 increase the size of a pipe, due to the
22 history that I have been exposed to in
23 reviewing work orders for the extension of
24 mains, looking at the cost of pipe relative

1 to the total cost of those extensions, with
2 the pipe coming in at 10 to 15% of the total
3 capitalized cost of the extensions, my
4 reflection of fully 50% of the cost of mains
5 on peak demands rather than a very much
6 smaller 10 to 15%, even if that pipe cost is
7 a percentage of total investment costs were
8 at 20% and you get the kind of economies of
9 scale from pipe size where the through-put
10 varies not with the diameter of the size of
11 the pipe but with the square of the--
12 actually, the square of the radius, the area
13 increases with the square of the radius and
14 the through-put increases with the square of
15 the increase in the size of the radius or the
16 diameter. The arithmetic and the information
17 that I've seen suggests that the very much
18 smaller portion of the pipes could be--an
19 argument could be made to allocate that on
20 peak demands as a conservative movement
21 toward the initial recognition of volumes in
22 a cost of service study. In this
23 jurisdiction I allocate fully 50% on peak
24 demand leaving only 50% to be allocated on

1 volumes.

2 Q You agree with Mr. Estomin, don't you, that in
3 Delta's last rate case, Number 97-066, the
4 Commission indicated an explicit preference for
5 the zero intercept method? On about page 23, I
6 don't remember exactly.

7 A Yes, I do and that is in a section of the
8 report where the Commission is discussing
9 whether the minimum system or the zero
10 intercept system should be utilized. And in
11 that context it expressed a preference, if
12 you are going to use the customer component,
13 to use the zero intercept method.

14 Q The Commission was really talking about their
15 determination that the average and peak
16 methodology did not have sufficient
17 reliability to warrant the Commission's
18 complete reliance, wasn't it?

19 A That may--

20 Q It's page 24, I apologize.

21 A --may also be in that Order. What was the
22 page reference?

23 Q Page 24.

24

1 MS. BLACKFORD:

2 I'm not sure you all are looking at the
3 same case, I think he has miss-heard the
4 case reference, possibly.

5 Q It's at the bottom of page 23, I apologize.
6 And the question is simply you agree, don't
7 you, that the Commission stated in that Order
8 explicitly that it had a preference for the
9 zero intercept methodology?

10 A Those words appear there, I have seen this
11 before. And in the very next paragraph the
12 Commission also states while recognizing the
13 weakness of the average and peak methodology,
14 as it was apparently presented in that case,
15 of which I do not know the details, the
16 Commission again indicated that the
17 Commission finds that both studies provide
18 some usefulness in establishing Delta's rate
19 design and will use them. So, apparently,
20 the Commission did consider and utilize the
21 results of that study on the basis of my
22 reading of its order.

23 Q Thank you. Let me get you to turn to your
24 response to Item 26 of the PSC Data Request. Do

1 you have that before you?

2 A Not quite. Yes, I have it.

3 Q In your response to Item B of that request
4 you say, "Mr. Galligan has modified the Delta
5 COS by allocating distribution main costs on
6 the basis of class average and peak demands,
7 replacing Delta's proposed class customer and
8 peak demand method." Is that what you said
9 in answer to that question?

10 A Yes.

11 Q Now, would you look at Delta's Data Request, Item
12 83, the one where you submitted your work papers?

13 A Yes, I have it.

14 Q Let me get mine out. At pages 83-3 to 83-5
15 is it correct that you functionalize
16 transmission plant costs as 50% demand
17 related and 50% commodity related?

18 A What was the category cost?

19 Q Transmission plant?

20 A Yes. That is clearly shown on those work
21 sheets.

22 Q Then on pages 83-9 through 83-14 is it true
23 that you allocated the demand related costs
24 to the customer classes based on demand and

1 the commodity related costs based on
2 commodity?

3 A Well, the nomenclature of the terms that you have
4 used in your question, I allocated the
5 transmission costs half on class peak demands and
6 half on class average demands, similarly to the
7 distribution costs.

8 Q And that was transmission costs you just
9 described there?

10 A Yes.

11 Q The functionalization and allocation methodology
12 that you use is not the same as Delta's which is
13 set forth in Seelye's Exhibits 1 and 2; correct?

14 A The functionalization and which?

15 Q Allocation methodology?

16 A No, we do differ on the allocation of the
17 transmission mains and the distribution
18 mains.

19 Q Look at page 83-5, I believe you state on
20 there that the investment represented by
21 distribution mains is 39,176,572? I got that
22 by adding those two numbers together.

23 A I'm sorry, I don't have a copy of the--okay,
24 would you give me a moment, please?

- 1 Q Sure.
- 2 A Okay, I'm with you.
- 3 Q Okay. The question that was pending is
- 4 whether or not it was true that the
- 5 investment represented by distribution mains
- 6 is 39 million plus as shown in the--by adding
- 7 together the two columns identified as
- 8 distribution mains demands and distribution
- 9 mains commodity; isn't that right?
- 10 A That looks about right form the line called
- 11 net cost rate base.
- 12 Q Right. And isn't it also true that the
- 13 investment represented by transmission mains
- 14 is a little bit in excess of \$22,000,000;
- 15 right?
- 16 A Approximately.
- 17 Q I get \$22,174,092; does that sound about
- 18 right to you?
- 19 A Well, neither piece exceeds ten million, six,
- 20 so--
- 21 Q What I'm looking at is the line called "Total
- 22 Net Utility Plant" right in the middle of the
- 23 page?
- 24 A Yes.

1 Q And then look at the columns that are
2 entitled "Transmission Demand and
3 Transmission Commodity."

4 A Yes, I see it.

5 Q Do you agree with me?

6 A Yes, I do.

7 Q Okay. Now, you didn't state in your answer
8 to the PSC's Data Request that you
9 reallocated this 22 million plus of
10 transmission mains, did you?

11 A I believe I indicated that the--right. Then I
12 talked about distribution mains in my testimony.
13 Back on page eight at the very top I indicate that
14 the cost associated with investment in mains is
15 misallocated due to Delta's introduction into its
16 cost of service study of the minimum system
17 concept, in this case the zero inch system.
18 Upstream of services investment back into the
19 allocation of the mains investment, consistent
20 with that testimony once you get into that part of
21 the system where the system is designed on the
22 basis of loads placed upon it, which wasn't the
23 case with services as we discussed yesterday with
24 Mr. Jennings--excuse me, with Mr. Seelye. While

1 the service has to be sized to take the load from
2 the mains to the customer premises, he agreed, I
3 believe, that the system from that point back has
4 to be deigned to meet the peak loads. And so, the
5 changes that I have made are to take the system
6 from that point back and reallocate them on what,
7 obviously, I believe are better--is a better cost
8 basis than pretending that investment had
9 something to do with a number of customers or
10 relies totally on peak demands.

11 Q Mr. Galligan, on page--at the very bottom of
12 page five going over to the top of page six
13 of your testimony, you state mains investment
14 at in excess of \$39,000,000 represents the
15 largest single category of cost in Delta's
16 system as is generally the case for local gas
17 distribution companies; do you see that?

18 A Yes, yes.

19 Q You don't mention the \$22,000,000, then, in
20 transmission mains thought, do you there?

21 A No, not there. But as I said and as you
22 indicated in your question, it is clearly
23 evident from the work papers that I provided
24 in--accompanying this testimony.

1 Q Would you look at page 83-15, again, of course
2 this is part of your work papers filed in response
3 to Data Request, Item 83.

4 A Excuse me, it's like the scissors at home, I
5 seem to have missed them, misplaced it.

6 MS. BLACKFORD:

7 83?

8 MR. WATT:

9 83-15, yes.

10 MS. BLACKFORD:

11 Seems like to me they keep running away
12 don't they?

13 A Yes, sir.

14 Q Now, isn't it true that if you look at--see
15 the expense adjustments there, it starts
16 about the middle of the page on the left hand
17 side?

18 A We are on 83-15, not 13, okay, yes.

19 Q Now, beneath that there are a bunch of sub
20 categories; isn't that correct?

21 A Yes.

22 Q Look at the one that is called "Expense
23 Adjustments" and then look at "Payroll Expense,"
24 do you see that one?

1 A Yes.

2 Q Now, you allocated that item to the classes
3 on the basis of demand; correct?

4 A Yes.

5 Q Now, Seelye did not do that in his cost of service
6 study, did he, Seelye Exhibit 2?

7 A I would have to check that and it was not our
8 intention to alter that \$116,000 amount.

9 Q Why don't you get Seelye Exhibit 2 and turn
10 to page 2-29 so you can see how he did it and
11 confirm to me that you did it differently?

12 A 39 or 29?

13 Q 29, 2-29, actually, yes, Exhibit 2, page 2-29, do
14 you have that?

15 A Yes, the--if you will bear with me a moment.

16 Q Okay.

17 A If you will look with me between these two
18 exhibits--

19 Q Okay, go ahead.

20 A --at each class amount that has been
21 allocated to each class you will see they are
22 identical. We submitted a data request to
23 help us understand this portion of your study
24 and the intent was not to change it but to

1 duplicate it, and from the numbers I have in
2 front of me it looks like while the
3 denotation of the allocation vector is DEM-01
4 instead of LBTT, it looks like, in fact, it
5 has not been allocated any differently in our
6 study than in your study.

7 Q Are we dealing with a difference in
8 terminology in your view or what?

9 A Yes, simply an indication of what that allocation
10 factor is that took that cost to class.

11 Q Would you look at--going back to you 83-15,
12 would you look at the expense adjustment that
13 is entitled "Eliminate Test Year Expenses?"

14 A Yes, and, again, it looks like same
15 explanation, difference in what the factor
16 has been called but no difference in the
17 allocation of the cost to class.

18 Q Excuse me, go ahead.

19 A No difference in the allocation of cost to
20 class.

21 Q You had allocated it to DEM-01 and the Delta cost
22 of service study allocated it to OMTT but you say
23 they--you think that is the same; is that your
24 testimony?

- 1 A It is allocated the same, yes. The
2 nomenclature for the allocation factor is
3 different.
- 4 Q Would you look on down, again, on 83-15, "Expense
5 Adjustments" and then "Customer Deposits," do you
6 see that one?
- 7 A Yes.
- 8 Q That was also allocated on the basis of
9 demand; correct?
- 10 A Again, if you look at the detail that ended
11 up in each customer class it is identical on
12 my study and the company's study.
- 13 Q Except that the company calls it OMTT and you
14 call it DEM-01?
- 15 A Yes.
- 16 Q And medical adjustment appears to be the
17 same, you have allocated it on the basis of
18 demand, right?
- 19 A Again, the amounts in each customer class are
20 identical to those that the company put in
21 each customer class, the nomenclature of the
22 allocation factor is different.
- 23 Q Now, let me make sure I understand. We don't
24 have any allocation terminology difference on

1 these transmission mains, you just didn't
2 mention them, did you; correct?

3 A They are clearly shown in the document to
4 which we have been referring which is--what I
5 did when I filed my testimony I put just the
6 summary page in because I found very few
7 commissions that are really going to get into
8 the detail that we have been getting into,
9 for example. When you asked for the work
10 papers I provided them and they very clearly
11 indicate that I have allocated transmission
12 half on annual demands, half on peak demands,
13 same as for distribution. My testimony
14 discussing the rationale behind that is,
15 again, as I indicated on the top of page 10.

16 Q Okay. Let me just make sure that I'm clear
17 about where you are, Mr. Galligan. You use a
18 different allocation methodology, and
19 intentionally so, than Delta on distribution
20 mains and transmission mains, right?

21 A Yes, sir.

22 Q But you think that you are using the same
23 allocation methodology as Delta on these expense
24 adjustment items that we have discussed, you think

1 we are only using different nomenclature; correct?

2 A Yes, yes.

3 Q Are there any other allocations that you made
4 different than the way Delta allocated besides
5 these two, distribution and transmission?

6 A No, if you understand, as I'm sure you do,
7 that when a cost of service study is
8 performed there are what I think of as
9 primary allocation factors that are input,
10 and then the study itself will calculate some
11 internal allocation factors. For example, if
12 the company doesn't know how to allocate some
13 O&M expense and it decides I'll allocate it
14 on the sub total of production and
15 transmission and distribution plant added up.
16 Of course, those would be different in my
17 study because I have changed the allocation
18 of those cost to class, but with that
19 exception those are the only two changes that
20 I made to the study.

21 Q Now, are there any other items, other than
22 the \$22,000,000 worth of transmission plant,
23 that you fail to mention or support through
24 your testimony, whether it had different--

1 A Well, I can't agree with that calculation or
2 with that statement.

3 Q Well, I think your testimony was that you--
4 just a moment ago, was that you just did a
5 summary form of testimony but the information
6 about the allocation of the transmission
7 mains was revealed to us through the work
8 papers. And my question to you is, is there
9 anything else that is like that?

10 A Now, that was not my complete answer. I also
11 indicated that at the top of--I said page
12 ten, looking at it now, again, it appears at
13 the top of page eight, there is an
14 explanation of the rationale for allocating
15 investment upstream of services, back into
16 the mains, on the basis of both peak demands
17 and average demands.

18 MR. WATT:

19 I think that is all we have Your Honor.

20 VICE CHAIRMAN HOLMES:

21 Staff?

22 MR. WUETCHER:

23 Just a few.

24

1 CROSS EXAMINATION

2 BY MR. WUETCHER:

3 Q On what basis did you choose to split transmission
4 and distribution costs equally?

5 A Explained on about pages 10 through 15 is the
6 concept that increasing the capacity of a gas
7 distribution system is very cheap at the
8 margin. And as I just discussed a little bit
9 earlier, what the company--probably no more
10 than 10 to 15% is the cost of the pipe for a
11 project and that is the cost that would
12 change, essentially, if you needed to build
13 your system with a little more capacity than
14 you are otherwise thinking of. And, in fact,
15 even just doubling the size from two to four
16 inch, which is the major pipe editions that
17 Delta is in the business of putting in these
18 days, it gives you a four fold increase in
19 the capacity of the system. And when you get
20 that kind of an increase in the capacity at a
21 very low marginal cost, and recognizing as
22 Professor Bonbright says, that, and I think
23 it is pretty well accepted in the industry,
24 that it is the incremental costs that belongs

1 on peak. There is very little cost should be
2 allocated on the peak. Because this is the
3 first time that a study, hopefully, will be
4 used by the Commission in this jurisdiction
5 that recognizes energy, I have very
6 conservatively put 50% of the cost of these
7 transmission distribution mains on energy
8 rather than their much larger percentage,
9 with a very much smaller percentage properly
10 being associated with peak demands.

11 Q Can you explain why you didn't use the
12 results from Dr. Estomin's unweighted
13 regression that yielded a 33% allocation to
14 customer charges?

15 A Yes. If you read my testimony you will see
16 the basis of my belief that once you get up
17 stream of the service line that runs from,
18 let's call it the center of the street where
19 the main is buried over to an individual
20 premises, then that part of the system is
21 designed to flow to numerous customers their
22 annual requirements and because they don't
23 require the same amount each and every day,
24 some small incremental cost of that system is

1 related to providing their peak requirements
2 as well as their annual requirements. And
3 that is why I've allocated that on the two
4 basic causes of cost, the fact that people
5 have annual demand for natural gas in such
6 sufficient volumes that they can amortize as
7 it were or relate the total cost of service
8 to enough volumes to get the average price
9 down to where it will compete with alternate
10 fuels. And, in addition, they also get a
11 peak load related cost allocation, and that
12 contrast with the company where when you
13 think about what Delta does is it takes gas
14 from, basically, at city gates, the service
15 it provides is bringing that gas to the
16 customers premises. It may stop for a little
17 while in storage but it comes out of storage
18 and goes to the customers premises. Delta is
19 a distribution company. And the irony of
20 their study is they haven't allocated any of
21 that which they are about, their distribution
22 transmission system, on the basis of
23 customers demands for gas. They believe that
24 all this is related to customers just being

1 there, not using any gas, or what the
2 customer is doing on a design day, which for
3 Delta happens about once every two years,
4 given its definition of design day weather.

5 Q Would you agree that the adjustments that you
6 have made to Mr. Seelye's cost of service
7 study have, in effect, shifted or increased
8 the cost that would be allocated to larger
9 customers and special contract customers?

10 A If you look at the results of my study
11 compared to the results of Mr. Seelye's
12 customer demand study, that is true,
13 generally true.

14 Q Okay. Now, do you believe that there is a
15 point at which larger customers and special
16 contract customers may leave the system if
17 the rates which Delta charges are increased
18 significantly?

19 A Yes, but my revenue spread does not do that.
20 If you look at, for example--

21 Q Well, I'm just--you are in agreement, though, that
22 where there is--if the costs are increased for the
23 large customers and the special contract
24 customers, at some point they may consider

1 alternative energy sources or other sources of
2 gas; would that be correct?

3 A Sure. There is something known as the law of
4 demand and if the price goes high enough
5 people with alternatives will shop around.
6 You mentioned special contract customers,
7 there is no proposed increase in my testimony
8 for special contract customers.

9 Q Okay. Do you agree that a cost of service
10 model should only be--should be used as a
11 guide in establishing rates?

12 A Oh, absolutely, and I have extensive
13 testimony on that point, yes.

14 Q Okay. And would you agree that there are
15 other factors that are also to be considered
16 in actually establishing rates?

17 A Absolutely, yes.

18 Q And would you agree that one of the factors
19 that should be considered in the
20 establishment of rates are the existence of
21 competitive pressures in the market place?

22 A If the price were to get you into a range
23 where that were a consideration, but, as I
24 indicated, my study increases interruptible

1 rates by eight cents more than the ten cent
2 increase that the company has proposed for
3 interruptible customers.

4 MR. WUETCHER:

5 That's all we have. Thank you.

6 CHAIRMAN HELTON:

7 Ms. Blackford?

8 MS. BLACKFORD:

9 No questions.

10 CHAIRMAN HELTON:

11 Mr. Watt?

12 MR. WATT:

13 I have no further questions, Your Honor.

14 CHAIRMAN HELTON:

15 You're excused. I believe that is your last
16 witness, Ms. Blackford?

17 MS. BLACKFORD:

18 That is our last witness.

19 CHAIRMAN HELTON:

20 I don't think there are any other matters. They
21 filed their motions--their response to motions.

22 MR. WUETCHER:

23 Yes, your Honor, both responses have been filed.

24 If I could, there are two very brief matters. One

1 is simply to note for the Commission what I think
2 I've previously noted very briefly in requesting
3 some information, that both parties have agreed
4 that Commission staff may submit to them some
5 questions in writing concerning the cost of
6 service studies that are of a technical nature and
7 better suited for responses in a written format
8 than the testimonial format here today. And the
9 parties have agreed that they would provide those
10 by--within two weeks of the time that they are
11 submitted by Commission staff.

12 MR. WATT:

13 That's correct.

14 MR. WUETCHER:

15 And the other matter is just to make an on the
16 record request. Mr. Hall, yesterday in his
17 testimony said that the short-term cost of debt
18 for Delta was now at 5.89% and we would request
19 that Delta provide us with some evidence to
20 support Mr. Hall's statement as to the--

21 MR. WATT:

22 Sworn testimony not good enough?

23 MR. WUETCHER:

24 Well, I think we want something to support that in

1 addition to his statement.

2 MR. WATT:

3 You're thinking of a document from a bank or
4 something?

5 MR. WUETCHER:

6 Yes.

7 MR. WATT:

8 Okay.

9 CHAIRMAN HELTON:

10 Any other matters we need to clarify? The
11 procedural schedule calls for briefs on this by
12 the 29. I'm assuming, Vivian, that the transcript
13 counting from today will be the 12th; is that
14 correct?

15 COURT REPORTER:

16 Yes.

17 MR. WUETCHER:

18 Your Honor, I'm sorry to interrupt again. There
19 has been a number of requests made back and forth,
20 if I could suggest to the Commission that those
21 all be filed no later than 14 days from today so
22 that all the requests that have been made by the
23 various parties can be met.

24

1 MS. BLACKFORD:

2 You said the transcript will be available--

3 CHAIRMAN HELTON:

4 The 12th.

5 MS. BLACKFORD:

6 The 12th.

7 CHAIRMAN HELTON:

8 Are the parties in agreement with Mr. Wuetcher's
9 request?

10 MR. WATT:

11 That's fine, Your Honor, 14 days from today?

12 CHAIRMAN HELTON:

13 From the day that you get it, I believe he said.

14 MR. WUETCHER:

15 I think 14 days from today, as far as requests
16 that have been made either today or yesterday.

17 CHAIRMAN HELTON:

18 Anything else? If not, we are adjourned.

19 (OFF THE RECORD)

20

21

22

23

24

CERTIFICATE

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STATE OF KENTUCKY)
COUNTY OF FRANKLIN)

I, VIVIAN A. LEWIS, a Notary Public in and for the state and county aforesaid, do hereby certify that the foregoing testimony was taken by me at the time and place and for the purpose previously stated in the caption; that the witnesses were duly sworn before giving testimony; that said testimony was first taken down in shorthand by me and later transcribed, under my direction, and that the foregoing is, to the best of my ability, a true, correct and complete record of all testimony in the above styled cause of action.

WITNESS my hand and seal of office at Frankfort, Kentucky, on this the 10th day of November, 1999.


VIVIAN A. LEWIS
Notary Public
Kentucky State-at-Large

My commission expires: 7-23-01

Vivian A. Lewis

COURT REPORTER - PUBLIC STENOGRAPHER
101 COUNTRY LANE
FRANKFORT, KENTUCKY 40601

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BEFORE THE
KENTUCKY PUBLIC SERVICE COMMISSION

CASE NO. 99-176

FILED

NOV 09 1999

**PUBLIC SERVICE
COMMISSION**

RE: DELTA NATURAL GAS COMPANY

Pursuant to notice duly given, the above-styled matter came to be heard October 28, 1999, at 9:00 a.m. in the Hearing Room of the Kentucky Public Service Commission, 730 Schenkel Lane, Frankfort, Kentucky 40601; The Honorable B. J. Helton presiding.

VOLUME I OF II

VIVIAN A. LEWIS
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(502) 695-1373

BEFORE THE
KENTUCKY PUBLIC SERVICE COMMISSION
CASE NO. 99-176

RE: DELTA NATURAL GAS COMPANY

APPEARANCES:

Hon. B. J. Helton
Chairman
PUBLIC SERVICE COMMISSION

Hon. Edward J. Holmes
Vice Chairman
PUBLIC SERVICE COMMISSION

Hon. Gary Gillis
Commissioner
PUBLIC SERVICE COMMISSION

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1 CHAIRMAN HELTON:

2 Good morning. We are here in the matter of an
3 adjustment of rates of Delta Natural Gas Company,
4 Incorporated, Case Number 99-176. Could I have
5 appearance for the parties please?

6 MR. WATT:

7 Robert Watt, Stoll, Keenon & Park, Suite 1000, 201
8 East Main Street, Lexington, for Delta Gas.

9 MS. BLACKFORD:

10 On behalf of the office of the Attorney General,
11 Elizabeth Blackford, Assistant Attorney General,
12 1024 Capital Center Drive, Frankfort.

13 MR. WUETCHER:

14 On behalf of Commission Staff, Gerald Wuetcher and
15 J. R. Goff.

16 CHAIRMAN HELTON:

17 Is there any member of the public that would like
18 to give public comment before we begin the
19 hearing? I believe as a preliminary matter before
20 the Commission we have a motion by Delta. We have
21 a motion by the Attorney General's Office.

22 Neither party will have had a chance to respond to
23 those motions yet, so we will give you until the
24 close of business tomorrow to respond to each

1 other's motions. We will go ahead and take the
2 testimony today so as not to any further delay the
3 hearing. And then we will rule on the motions
4 after and take whatever actions are necessary
5 after we rule on the motions. Mr. Watt, you want
6 to call your first witness?

7 MR. WATT:

8 Glenn Jennings.

9 (WITNESS DULY SWORN)

10

11 The witness, GLENN JENNINGS, having first been
12 duly sworn, testified as follows:

13

DIRECT EXAMINATION

14 BY MR. WATT:

15 Q Glenn, would you please state your name for the
16 record?

17 A Glenn Jennings.

18 Q Where do you live?

19 A I live at 9 Fairway Drive in Berea, Kentucky.

20 Q By whom are you employed?

21 A Delta Natural Gas Company.

22 Q What is your position?

23 A I'm President and CEO.

24 Q Would you please briefly describe your

1 duties?

2 A I have a team of officers that report to me
3 that have the responsibility for various
4 portions of the company. I oversee their
5 efforts and oversee the overall efforts and
6 operations of the company.

7 Q Have you filed direct testimony on behalf of
8 Delta in this proceeding?

9 A Yes, I have.

10 Q Are there any changes, corrections, or
11 additions to that testimony?

12 A No.

13 Q If I asked you the questions contained in your
14 direct testimony today, would you give the same
15 answers?

16 A Yes.

17 Q Have you filed rebuttal testimony on behalf
18 of Delta?

19 A No, sir.

20 MR. WATT:

21 We have no further questions. We would
22 move the admission of Glenn's direct
23 testimony into the record.

24

1 CHAIRMAN HELTON:

2 So ordered. Ms. Blackford?

3 MS. BLACKFORD:

4 Thank you. I have no questions for Mr. Jennings.

5 CHAIRMAN HELTON:

6 Mr. Wuetcher?

7 MR. WUETCHER:

8 I have a few for Mr. Jennings.

9

10 CROSS EXAMINATION

11 BY MR. WUETCHER:

12 Q Mr. Jennings, did you agree that--well, is it the
13 responsibility of Delta's management to monitor
14 Delta's operations and capital structure to insure
15 its financial integrity is maintained?

16 A Yes, that's one of the things that we do, I
17 agree with that.

18 Q Okay. How does Delta monitor its operations
19 and capital structure?

20 A Well, we, I guess, are continuously
21 monitoring our operations through the various
22 people we have working for us in the 21
23 counties that we serve. And we monitor our
24 financial performance and our capital

1 structure as just a part of our day to day
2 overseeing the company, trying to keep
3 ourselves in a position where we can be able
4 to raise capital to do what we need to do in
5 the future.

6 Q Well, let me--If I can, I'd like to go ahead
7 and refer you to Delta's response to the
8 Commission's Order of June 4, 1999, in Case
9 Number 99-046. And in that question Delta
10 was asked what operations, what analysis of
11 its finances and operations that it performed
12 to determine whether it was unable to earn
13 its authorized rate of return. And as I read
14 that response it's, basically, that Delta did
15 not perform any such analysis. Now, do you--
16 first of all, do you agree with the
17 characterization of that response and, number
18 two, do you agree with the response that was
19 submitted to the Commission?

20 A You know, it would be helpful to me, there
21 have been--we have responded to ten data
22 requests in this case. It would be helpful
23 to me if I could maybe just look at that
24 particular one.

1 MR. WATT:

2 Could I have the number again, please,
3 Jerry? I'll show it to him.

4 MR. WUETCHER:

5 It is the first response to the first
6 information request of the June 4, 1999,
7 Order.

8 MR. WATT:

9 Item number one?

10 MR. WUETCHER:

11 Yes, sir.

12 Q The question that was asked--do you have that?

13 A Yes.

14 Q The question that was asked was what analysis of
15 its finances and operations, if any, has Delta
16 performed to determine why it has been unable to
17 earn its authorized rate of return over the last
18 ten years. And the response was Delta has not
19 performed any formal analysis except the
20 information provided as part of the company's
21 budget. Would it be correct for me when I
22 characterize that response as saying that there
23 are no formal procedures or processes, would that
24 be a correct characterization of the response?

1 A No, it would not, I don't think. John Hall
2 responded to this, but John and I conferred
3 on this and I think the point that we were
4 trying to make there, and you can ask him the
5 question as well, but the point that we were
6 trying to make was that we, annually, as we
7 look at our budgets and financial plans for
8 the next year, always analyze where we are
9 and what our position is going to be and what
10 things look like for the upcoming year before
11 we present it to our Board. And each spring
12 we evaluate our financial results, look at
13 our budget for the next year, our expected
14 return, we look at our capital structure, we
15 look at everything. And then we come with it
16 to our Board at the May Board meeting for
17 them to review, consider and approve or
18 change. And so, I would say--I wouldn't want
19 to give the impression that Delta is just
20 sort of drifting aimlessly because we don't
21 consider that to be the case. We think we
22 really scrutinize ourselves very hard about
23 how we are doing and where we are headed.
24 But we do it in the context of budgetary

1 looks once a year, and I think that is what
2 we tried to say there. I think the point was
3 we have not stopped and done any formal
4 analyses other than what we do on an annual
5 basis.

6 Q Okay. Well, the response makes reference to
7 a document that was attached to Delta's
8 response to the Attorney General's
9 Information Request of June 4. And that is--
10 I don't know if you have got that, the
11 responses--the first Item 93 of the AG's data
12 request?

13 A Okay. Okay, I have that.

14 Q So, is this--when you talk about formal
15 analysis, the analysis that you are talking
16 about is just this budget detail or budget
17 income statement, but the documents that are
18 attached is--a part of a budget statement?

19 A Well, what is provided in Item 93 is Delta's
20 budget that was presented to our Board and
21 the Board approved. And in doing that we
22 always look at where are we financially? We
23 project our earnings per share, our cash
24 flow, our dividend requirements, our capital

1 structure and everything connected with the
2 company.

3 Q Are those projections also part of the
4 planning process?

5 A Well, you know, quite frankly it is
6 impossible to operate in such a vacuum that
7 you don't look at those things all the time
8 if you are in the financial management of the
9 company. There is no formal process that
10 says, okay, at this particular time we are
11 going to look at all of those things, we do
12 it all the time. But once a year we stop,
13 project all of our expenses, our capital
14 spending, all of our needs and put that in a
15 formal budget and present it. And that is
16 what Item 93 was.

17 Q And that is all transmitted to the--I take
18 it, to the Board of Directors?

19 A That's correct. It is sent to the Board in
20 writing and then it is presented to the Board
21 by myself and sometimes I have some of the
22 management, like John Hall and others, sit in
23 and we go through the budget in detail with
24 the Board.

1 Q When you say it is submitted in writing, is
2 there some type of narrative or analysis that
3 goes along with this document?

4 A Well, this information here is the detail by
5 account for every account in the company.
6 And all those accounts are assigned to one of
7 the members of management, so every
8 operating account, every expense account,
9 every capital account, every capital
10 expenditure account are listed here. So,
11 that is all the detail of all the accounts in
12 the company. And then we assign those to
13 people and they are responsible for those as
14 we go through the year as to how we do versus
15 how we plan to do. So, this right here is
16 presented to the Board and then we go through
17 and discuss those and highlight anything in
18 those, particularly changes from the previous
19 year, or things that are unusual, or things
20 that are different than perhaps they were the
21 year before, that sort of discussion. It is
22 sort of a give and take discussion that
23 covers a period of time with the Board. It
24 is not just, you know, a one minute sort of

1 thing. It is a fairly detailed discussion.
2 But I don't know that we don't always have a
3 particular format in which we present that
4 other than this sort of format which is all
5 the detail by account and it compares always
6 to the previous periods of time so they can
7 see how things are looking compared to budget
8 and how they vary.

9 Q Let me make sure I understand, this goes--
10 this document goes to the Board of Directors
11 and then each management official that is
12 responsible for a particular account then
13 gives some type of briefing to the Board of
14 Directors, there is nothing in writing that
15 accompanies this material?

16 A Well, generally--well, it might not always be
17 --that's not completely accurate. It might
18 not always be that each person that's
19 responsible for each account will be there to
20 do that. I will be there to do that and I
21 will bring those other people in as I choose
22 to. This past year when we did it I brought
23 all the officers into the Board meeting and
24 we went through and reviewed all the budget.

1 There are years when I only brought some of
2 them in, it depends on the nature of what is
3 in the budget and what I assess the need to
4 be. I mean, I view that as just part of my
5 job and part of my judgment to call that.

6 Q Okay. I guess what I'm trying to clarify
7 here is where there has been a lack of
8 documents, you are saying that there is--this
9 is the basic document; correct?

10 A Correct.

11 Q Then accompanying that is the verbal briefing
12 that is made by the various officers so that
13 the Board of Directors is kept up to date on
14 what is going on?

15 A That's correct, and that verbal briefing
16 might be myself, it might be John Hall in
17 some of the accounts, it might be some of the
18 other people, Johnny Caudill, Allen Heath,
19 whoever is involved, where I feel like we
20 need to highlight an area or spend more time
21 on it. Those people utilize the management
22 under them to develop the budget. We start
23 the process in February, generally, and we
24 work on our budgets February, March and April

1 and we work on our salary adjustments, we
2 work on anything that we are going to be
3 proposing early on in the year. And there is
4 a lot of detail that each of these people
5 develops that eventually comes up to the top
6 budget. Well, you don't give your Board, you
7 know, that much detail to go through when you
8 talk about budgets, you give them the budget
9 and you compare it on key comparisons, you
10 give them the overall look about cash flow
11 and EPS and capital structure and then you
12 respond to questions or you highlight those
13 things that you think are important for them
14 to know about. That is the way I handle it
15 and that is the way I choose to try to handle
16 the budget process for Delta.

17 Q And the budget is approved--the Board of
18 Directors meets what, quarterly?

19 A Meets quarterly normally, it is a routine,
20 the third Thursday of each quarter.

21 Q And the budget is normally approved at what
22 quarterly meeting?

23 A At the May Board meeting which is generally
24 the third Thursday in May and those are--

1 those quarters are February, May, August and
2 November are the four quarters.

3 Q And after the May meeting, is there any type
4 of update given to the Board of Directors by
5 management as to how the company is doing in
6 relation to the budget that was approved in
7 May?

8 A Yes, two ways. First, myself and our
9 Chairman are on the Board, so we are Board
10 members, and monthly we have monthly internal
11 reports that compare every account, expense
12 and capital, to budget. We review those, I
13 review them in my management meetings with
14 the officer team, and we discuss variations
15 and I expect responses on how we are doing
16 compared to how we thought we were going to
17 be doing. Secondly, then, at each quarterly
18 Board meeting after May, I go through the
19 results, compare the budget with the Board,
20 and highlight and explain anything that is
21 different or things that I feel like they
22 need to know about. They ask any questions
23 and we have a very thorough discussion about
24 where the company is financially each quarter

1 as we go through that year compared to where
2 we had planned to be.

3 Q Have you had an opportunity to review Dr.
4 Blake's response to the Commission's Order of
5 September 14, 1999, Item 31? I think your
6 counsel is pulling out a copy for you right
7 now.

8 A I'm glad, I'm sure I've seen it.

9 Q Well, let me go on and you can tell me if you
10 are familiar with it. That response, Dr.
11 Blake, among other things, states that Delta
12 has "experienced an almost continual decline
13 in the equity component of its capital
14 structure over the last ten years." And he
15 states that Delta has "all the unmistakable
16 signs of financial distress" and refers to
17 "Delta's alarming financial trends." Would
18 you agree with Dr. Blake's statement and his
19 description of Delta's trend?

20 A That was Item 31?

21 Q Item 31.

22 A Your question was do I agree with his response to
23 Item 31?

24 Q Yes, sir. Or does his--well, do you agree

1 with his description that Delta has
2 experienced an almost continual decline in
3 the equity component of its capital structure
4 over the last ten years?

5 A Yes.

6 Q Okay. Would you agree with his statement
7 that Delta has the unmistakable signs of
8 financial distress?

9 A Yes.

10 Q And would you agree with his characterization
11 of the last ten years as an alarming
12 financial trend?

13 A Yes.

14 Q Can you tell us what events occurred between 1989
15 and 1998 that caused the decline in Delta's equity
16 component of capital structure?

17 A There are several. I guess the--I studied
18 this a little bit last night, because I was
19 setting around with nothing to do, the world
20 series was over, the Yankees had won, and I
21 thought I look at that one more time just to
22 refresh myself. And I didn't go back and
23 look from 1989 to 1999 but I did look at
24 least the last five years. And Delta's--

1 first of all, Delta hasn't earned it dividend
2 in but one of the last five years. So, we
3 have four years out of five that we have paid
4 out more than we earned, in effect. Our
5 payout ratio is greater than 100%. And I
6 looked at our retained earnings, what happens
7 when you have that happen is your retained
8 earnings tend to decline, if you pay out more
9 than you earn. And our retained earnings--I
10 looked at the last four years--from 1996 our
11 retained earnings were almost \$2.8 million.
12 And now they are--at June 30, '99, they are
13 just a million. So, that is a million eight
14 decline or 63% decline in our retained
15 earnings. And what that means is if your
16 retained earnings eventually get down to
17 nothing, is you cannot pay any more dividends
18 when you run out of retained earnings.
19 Retained earnings are there to buffer you
20 against times when you don't perhaps earn
21 what you pay and to provide funds to
22 reinvest. And so, that--that is one thing
23 that has hurt us from a capital structure
24 standpoint is just the decline in retained

1 earnings. But what has led to that has been
2 a combination of things. I would say in our
3 last rate case, which was in 1976 test year,
4 it was resolved in 1977, we felt that--

5 MR. WATT:

6 '96-'97.

7 A Pardon?

8 MR. WATT:

9 '96-'97.

10 A Yes. And we felt that--we felt that we
11 needed more revenues than what we received in
12 that case, and we really felt it at the time,
13 I think expressed that, that that was going
14 to make it tough on us to earn our dividend,
15 and I think that prophesy came to be true.
16 That is only part of it, part of it is
17 weather. I mean, we have had some very warm
18 winters and, as you know or may not know from
19 what is in the case, we are very weather
20 sensitive on our sales. And I look back at
21 our degree days, at least last four or five
22 years, in 1995 the weather was only 90% of
23 normal, '98 it was 93%, '99 was 89%, so we
24 have had some weather related impacts. We

1 have had increase in costs since our last
2 rate case. We have invested more money in
3 capital, some of it produces additional
4 revenues, some does not, some is replacement
5 of existing facilities. We are now replacing
6 some facilities, some transmission pipe lines
7 that are old and aged and need to be replaced
8 really from a safety and operational
9 standpoint that don't generate additional
10 revenues. We have had increase in cost, you
11 know, for payroll and benefits, health care,
12 some of the things way beyond our ability to
13 control that are influenced by other things
14 in the economy. And those things all have
15 contributed to the decline in earnings. And
16 our revenues just haven't been there to
17 enable us to offset those and to earn a
18 return that we need. So, I think all of
19 those have led us to the position we are in
20 right now which is a pretty distressed
21 position. When you--when you are a public
22 company paying dividends to shareholders and
23 trying to raise new money, and four of the
24 last five years you haven't earned your

1 return, and you are still out there trying to
2 provide service in a growing 21 county
3 community in Kentucky that is very rural and
4 spread out, it is very difficult to do. And
5 it does tend to make you feel distressed,
6 especially, after two or three years where
7 you didn't earn that. And you say I'm
8 concerned if I'm going to be able to raise
9 the equity and the capital in the future to
10 continue to do that.

11 Q Let me touch on those briefly.

12 A Okay.

13 Q You said this was the last five years. Would
14 you agree that the reasons that you gave,
15 aside from the reference to the last rate
16 case, that all those have been present for
17 the last ten years? If we take Dr. Blake's
18 analysis and move it back another five years,
19 those all didn't just pop up in the last five
20 years, then?

21 A Well those, all of those things that I talked
22 about, inflation, increase in cost, capital
23 spending and weather all have been there
24 really as long as Delta has existed, and I'm

1 sure the last ten.

2 Q Okay. And to the extent that these are all
3 part of a trend, I take it that Delta's
4 internal review processes would have picked
5 those trends up? Do you feel comfortable
6 that it's internal analyses that you say you
7 are conducting on a periodic or a continuous
8 basis have picked those up and got on your
9 radar screens pretty early on?

10 A I think that is correct.

11 Q Okay. Do you know, has Delta at any point in
12 this ten year period retained any type of
13 outside consultants or experts to examine its
14 operations or assess its financial condition
15 to make any recommendations to correct these
16 financial trends?

17 A I guess, probably not specifically for that,
18 I can elaborate if you would like.

19 Q Sure.

20 A There have been--well, one time when we underwent
21 a lot of scrutiny, and I don't know that we
22 necessarily--well, I guess we did hire it,
23 although we didn't invite it, was the management
24 audit that we had. We paid for it and they were

1 employed by us but it was a required thing. That
2 was a quite intensive scrutiny of Delta and its
3 operations and particular efficiencies and all
4 those sorts of things that went on for a couple of
5 years. And we implemented all the recommendations
6 of that audit, I think, and eventually resolved
7 all of those and implemented a great number of
8 those things to try to be as efficient as we
9 could. We have hired--over the years we have
10 hired outside consultants to assist us as we were
11 looking at preparing rate cases or whether we
12 needed to or how we might approach those, and we
13 have involved people from various consulting firms
14 that have given us their advice on what they
15 thought we should do or not do. And then, in
16 addition to that, we continuously talked with the
17 one group of people outside the company that have
18 a big stake in our financial performance and that
19 is investment bankers and analysts that work for
20 those banking firms. And Mr. Hall and I have an
21 ongoing dialogue with a lot of investment bankers
22 that might sell Delta's equity in the marketplace
23 in the future. And those people are always
24 advising us, usually it is verbally, but they are

1 advising us on how they feel about Delta's
2 financial position and whether they are concerned
3 about it and what are we doing about it, or what
4 steps are we taking. And they always say, well,
5 here is what people in other states or other
6 jurisdictions are doing, because they are always
7 dealing with the utility companies. And I speak
8 here, you know, of firms that are normally
9 underwriting public offerings for the most part.
10 And they have analyst and specialists on their
11 staffs. For instance, he and I met fairly
12 recently with a couple of those, just discussing
13 with him Delta's condition, where we were, the
14 fact that four of the last five years we hadn't
15 earned our common dividend and what we were trying
16 to do about that. I mean--because they--so they
17 do provide advice but to say we hired them, you
18 know, I don't--we might do business with them in
19 the future, but I couldn't say that we hired them
20 for that sole purpose.

21 Q Would you agree with Dr. Blake that one
22 solution to reversing the decline of the
23 equity component is a rate adjustment?

24 A One solution to reversing--

1 Q Reversing Delta's declining or decline in
2 equity component is a rate adjustment?

3 A Yes, to the extent that that would then allow
4 us to having earnings greater than the
5 dividends that we are paying out, yes,
6 because it would add to equity because
7 retained earnings would grow.

8 Q Okay. Are there any other solutions besides
9 the rate adjustment route, that you see?

10 A I suppose, you know, that you could always
11 say, well, maybe you should do less or maybe
12 you should reduce cost, but we feel that over
13 the last eight or ten years with the
14 management audit, with all of the other
15 things that we have done, that we are pared
16 down to what we consider very bare bones. I
17 haven't heard a lot of complaints during this
18 proceeding that we are--that we have a lot of
19 areas where we need to be more efficient.
20 And I don't see those or know of those, but I
21 guess that is the other possibility is to do
22 something like that. The problem with that
23 is, it hurts being able to provide service
24 like we are doing now, it hurts being able to

1 provide service to a growing service area.

2 That's the other side of that coin.

3 Q Well, then, would it be safe to say that the
4 solutions that you see are viable to your
5 problem are basically ones that are, at least
6 in part, dependent upon management decisions?

7 A I'm sorry, I didn't hear you.

8 Q The solution to your--to the decline in the
9 equity component is, in part, dependent upon
10 the actions that management would take?

11 Granted, for example, you can't
12 automatically--well, automatically is
13 probably a bad word, but you cannot adjust
14 your rates without the approval of the Public
15 Service Commission, but the first step to
16 doing that is making the decision to file for
17 a rate adjustment?

18 A That's correct.

19 Q Would the same thing be, for example,
20 changing your rate structure to, for example,
21 provide for a weather normalization factor
22 within your existing rates?

23 A That's true but, you know, on weather, you
24 know, our rates have always been set before

1 this Commission assuming normal weather.
2 That is the assumption, the 30 year average
3 weather is what is called normal, and we have
4 always had our rate set based on that. We
5 don't control the weather, obviously, but we
6 have always had the assumption that we could
7 earn our return based on normal weather. So,
8 that has always been something that has
9 always been before the Commission any time we
10 have had a proceeding.

11 Q Okay. Can you explain then, if a rate
12 adjustment is one solution to the financial
13 distress that Delta has been experiencing
14 during the last ten years, why did Delta
15 delay for almost six years before filing for
16 a rate adjustment in Case Number 97-066, back
17 in 1997?

18 A Okay. So, I'll back up and give you a little
19 history on that because I think that is
20 probably important. If I get off to a point
21 where you get tired of it, just stop me, but
22 I've been at Delta 20 years and we had a case
23 going on when I joined the company in 1979,
24 we had had an acquisition and we had a case.

1 During that time we had rate cases and I know
2 because I personally prepared and handled
3 them all for the company completely, except
4 for our legal side which I don't practice
5 law, fortunately. But--
6 Q At least not officially, right?
7 A No response. But we had rate cases in 1981,
8 `82, `84, `85, `90, `97 and now `99, or `96,
9 `97 and `99. That's the history and I know
10 because I have it permanently ingrained
11 somewhere within me having dealt with all of
12 those. But we had it--we tried rate cases
13 and we discovered in the `80s there that we
14 were spending an enormous amount of our time
15 and resources and very costly time with rate
16 cases trying to stay current with things in a
17 growing service area and trying to stay
18 current with our rates. And we said, well,
19 let's look at ourselves as well and let's try
20 to stay away from rate cases as much as we
21 can. Let's try to be as efficient as we can,
22 let's try to be as lean as we can, and that
23 was the--and that was what we did. So, from
24 `90 `til `96 there, that six or seven years,

1 we made a very conscious effort and we did it
2 through this process that we talked about
3 earlier of annually in the spring an internal
4 self investigation of the company. Where are
5 we? Where do we project we are going to be
6 next year; what do we project our earnings
7 are going to be; what do we project our cash
8 flows to be; how much credit line do we have;
9 how much is still available; you know, what
10 is our capital structure projected to be
11 like? We do that, as I said, at the outset
12 of this, every year we do that, very
13 intensive look. And each year that we did
14 that from 1990 forward, we concluded that we
15 felt that we could function during that year
16 without adjusting our rates. Now, part of
17 what we did, you know, is we did like every
18 other company in the state and the U.S., I
19 think, in the last few years, we downsized,
20 we right sized, we whatever term you want to
21 use, we did more with less, we served more
22 customers with fewer employees, all that
23 stuff. And we got down to where we
24 considered ourselves to be somewhat lean and

1 mean. That's always subject to
2 interpretation, depends on, you know, which
3 side of the coin you are on. But we tried to
4 do that, and in doing that we tried to
5 operate without adjusting our rates. And the
6 other reason we tried to do that is because
7 we deal with fairly significant competitive
8 situations in our service area with electric,
9 with Kentucky Utilities, which is now LG&E,
10 and with the RECCs. They have very low cost
11 electric power. They offer a lot of
12 incentives, they work hard with builders and
13 developers to encourage them to go all
14 electric in the things they develop and so,
15 we made a strong, strong effort to try to
16 keep our rates competitive and we still do
17 that. And so, we don't--it is not our choice
18 always to want to constantly raise our rates
19 because we have to deal with the price and
20 competitive issues with that when we do. So,
21 during the '90s we did that and that is one
22 reason, you know, that is one reason that we
23 didn't come back in last year for a rate
24 case. We, and you always assume in all that

1 process that you are going to have normal
2 weather. You assume over the long haul that
3 you are going to have normal weather and in
4 the past we have had a year when it is warmer
5 than normal, and maybe the next year it is
6 colder than normal so, you know, you make
7 more, you know, than normal weather would
8 provide you one year and you don't the next.
9 But I don't know if there is such a thing as
10 global warming or not, but I know that we are
11 in a trend that is alarming and leaves us in
12 the distressed position, partially in the
13 distressed position that you referred to
14 earlier. So--now, that is a long winded
15 answer and I didn't intend to make it that
16 way.

17 Q I appreciate that.

18 A But I wanted to let you know that that is
19 sort of the process that we have gone
20 through.

21 Q Would you agree with the statement that
22 Delta's decision to postpone coming in for a
23 rate adjustment in order to use these other
24 factors, in order to try to take other

1 methods to become more lean and mean or to
2 view other approaches may have contributed to
3 the financial distress that Dr. Blake refers
4 to in his response?

5 A I agree with you completely. I think that we
6 make the judgments at the company on whether
7 to file for rates or not. Now, we can always
8 be called in, but for the most part it
9 doesn't work that way. And we make those
10 judgments and we evaluate whether we do or
11 don't need to with always a bias towards not,
12 you know, because of the pricing and
13 competitive side of it. And we have made
14 those calls and those judgments, that's been
15 within the prerogative of management to make
16 those calls. We might not always make them
17 right, but we have made them.

18 Q Well, let me turn for a moment to, and I
19 think it has been called various names, and
20 I'll just refer to it as the Alternative
21 Regulation Plan that Delta has proposed. I
22 take it you had at least a hand in preparing
23 it?

24 A That's correct, I did.

1 Q Can you describes for us just what your role
2 was in it, in the preparation of it?

3 A Yes. The--I guess I was involved in looking at
4 what other companies do. For instance, I visited
5 Alagasco, I visited Atlanta Gaslight, I talked to
6 people that I know in the industry, I'm on the AGA
7 and SGA Boards and I talk with people at other
8 companies just to try to see what other people are
9 doing to deal with some of the things that we are
10 dealing with, particularly those companies that
11 have had better historic earned returns than us
12 and have not had the situation that we have had
13 for the last few years of not earning their
14 dividends, just trying to see what we could do
15 different in the way we are doing it. And I had a
16 couple of concerns, one was to provide what I was
17 looking for as a more--for lack of a better term,
18 more streamlined process and a less costly process
19 and so, I talked with people, I talked with people
20 on the Alabama PSC, Bob Reed, in particular, who
21 oversees the Alagasco Alt Reg, and I talked with
22 Bob about it to see how the staff viewed it. I
23 talked with people at Alagasco to see how they
24 viewed it and to see if they thought what they had

1 was working reasonably well. And they both did.
2 I visited with Atlanta Gaslight and I talked to
3 people there about what they were doing, looking
4 toward a way to streamline and to be less costly
5 because rate cases for us are costly. And we are
6 not the largest LDC in Kentucky, we are the
7 smallest of the five so-called big five or
8 whatever, you know, we are the smallest of those.
9 And a rate case like this is very expensive on
10 Delta Gas and its customers, so we were looking
11 for a way to try to do something without that, if
12 we could. And we finally decided that the
13 approach that Alagasco had was something to start
14 from because when you have something that both
15 this Commission and Staff and the Company are
16 comfortable with and the Attorney General's Office
17 and people that intervene there are comfortable
18 with that whole process, it seems to me like a
19 good starting point. So, my involvement was
20 involved more with that, with the overall look of
21 let's look at a different way to do things. Let's
22 don't just go with the status quo and that is what
23 we tried to do.

24 Q You mentioned two companies, Atlanta Gaslight

1 and Alagasco.

2 A Yes.

3 Q I guess Alagasco is the Alabama Gas
4 Corporation?

5 A That's correct.

6 Q Was your--and correct me if I'm wrong, but it
7 seems as if the focus of the plan that has
8 been proposed is based in large measure on
9 using the Alagasco plan as a model; would
10 that be correct?

11 A That would be correct.

12 Q What other states--or what--let's--first,
13 let's start off, what other companies besides
14 Atlanta Gaslight and Alagasco did you look
15 at?

16 A Those are the only two specific ones where I
17 spent a lot of time and actually visited and
18 talked about, you know, what are you doing.
19 We were also in the middle of, at the time,
20 of the ongoing unbundling debate and the
21 collaborative process and all that and so, I
22 was also at Atlanta Gaslight looking at what
23 they were doing from an unbundling standpoint
24 and how was that working or not working, and

1 talking with Alagasco about the same thing
2 which they had decided they did not want to
3 pursue and why did they feel that way. So,
4 it was, you know, it was more than just that
5 one thing, but it gave me the opportunity to
6 cover several things while I was there. And
7 I've talked in the associations about other
8 companies and things that they are doing.
9 And I finally thought--I finally focused in
10 on these two, because I thought that they,
11 maybe, were more close to what we might
12 consider doing here.

13 Q Well, correct me if I'm wrong, you would
14 agree that a lot of states are engaging in
15 alternative regulation policies. They are
16 experimenting with new things to see how they
17 can improve the system or make it work better
18 both for the utility and for the customers;
19 would you agree with that?

20 A Yes, I would, I would agree with that.

21 Q What other states besides Alabama and Georgia did
22 you look at?

23 A Well, I get a lot of information from the AGA
24 about what is going on in all of the 50

1 states because they are all involved, you
2 know, with AGA. And I go to all the NARUC
3 meetings and I, you know, the NARUC gas
4 committee and the winter and summer meetings
5 and I go to those and listen to the debates
6 that are going on about what is going on in
7 each state. And I guess other than those two
8 things--and the SGA, I go through them and
9 see what the SGA companies are doing. But
10 other than those meetings and just getting a
11 feel that everybody, like you say, is looking
12 at different things like performance base
13 rate making or PBRs as it's referred to or
14 ways to streamline the regulatory process. I
15 don't know that I looked specifically at any
16 other companies. I guess I looked at the
17 overall picture and then sort of focused in
18 on the ones that I knew, and that I had
19 personal, you know, real personal contact
20 with, I know the people at the companies and
21 I knew that they would be willing to spend
22 time with me and share in detail what they
23 were doing. So, then, I focused in on those
24 because of that.

1 Q Delta retains a consulting firm to assist it
2 in putting together its Alternative
3 Regulation Plan; is that right?

4 A We retained the Prime Group, Steve Seelye,
5 Randy Walker to work with us on it. Once we
6 had thought, this is something we really feel
7 like makes sense, not just for Delta Gas but
8 for its customers as well. Then, we said
9 let's look at developing that and are there
10 things about the--those approaches that we
11 would like to try to change. For instance,
12 not having a settle up mechanism in the
13 Alabama one, you know, because we thought
14 something that worked more like the PGA or
15 the GCR in Kentucky so that you don't always
16 settle up and be sure you really settle back
17 to a target return instead of just adjusting
18 once as they do there and working two or
19 three quarters and then start over again
20 without ever really settling.

21 Q When you retain your consultants, did you
22 tell them to go out and look at other states
23 or at least contact the officials and find
24 out what was going on and report back to you?

1 A No; no. No, we did not. We retained them to
2 help us develop an approach geared around the
3 approach that we thought made sense, which
4 was we finally decided was the Alagasco
5 approach.

6 Q So, when you retained the Prime Group you had
7 already made the decision that the Alagasco
8 model was going to be the--at least the basis
9 for your experimental plan?

10 A That's correct.

11 Q And prior to retaining the consultants, did
12 you go out and maybe at least contact--well,
13 what other state commissions did you contact
14 just to find out what they were doing or
15 considering or had approved?

16 A I contacted no state commissions, personally,
17 I don't think anyone on my staff did.

18 Q Okay.

19 A Like I said, we--but I did and I have for
20 several years now, gone to the winter
21 meeting, the summer meeting and the annual
22 NARUC meetings, the gas committee meetings,
23 the gas subcommittee meetings, and the
24 accounting subcommittee meetings, either

1 myself or John Hall. And so, we felt like
2 that we had a pretty good feel for what
3 people were doing or not doing as a result of
4 sitting and listening to commissioners talk
5 about what is going on in their state versus
6 our state versus their state, and then
7 getting the written stuff that we get and
8 stuff that is on the Internet now, you know,
9 from NARUC. And then, we went to AGA and did
10 the same thing because we are a member there,
11 and we went to SGA and did the same thing,
12 but we did not, to my knowledge, at least I
13 did not sit down and go through all of those
14 and say, okay, out of all those options, you
15 know, let's check them all off and decide on
16 Alagasco. It was more of a management
17 determination that, at some point, if we are
18 going to propose something different which of
19 all those things now that we have listened to
20 and heard do we think makes the most sense in
21 Kentucky. And we thought the Alagasco one
22 did.

23 Q Well, were there any other companies or plans
24 that you looked at and at least considered,

1 did a little research on, and then said, that
2 is just not right for us or that won't work
3 in Kentucky?
4 A No, I guess the only thing that I really
5 ruled out was Atlanta Gaslight's unbundling,
6 that's the--when I spent a couple of days
7 there and looking at--because built into
8 their unbundling is a whole different
9 approach to rate making. It is an approach
10 of a monthly customer charge, basically, and
11 really not metered service. And the more I
12 looked at that I walked away from that and
13 said, that has a lot of pitfalls and I can
14 see a lot of problems with that the first
15 year. And my prophesy has been borne out
16 maybe by accident but it has been. And we
17 just decided on that that we would not pursue
18 any of that, and then went back to the
19 Alagasco. We spent a lot of time looking at
20 it, talking with them, I visited there at
21 least a couple of different times, and was on
22 phone conversations with them and finally
23 concluded that that was as good model to
24 start from.

1 Q Okay. Well, I hate to beat a dead horse,
2 but I'm just still trying to find out the
3 field--the universe from which you selected
4 your model. And is it correct to say that
5 you really only seriously considered the
6 Atlanta Gaslight and the Alagasco model? The
7 other ones were looked at--well, it doesn't
8 sound like you looked at any other ones very
9 seriously at all. They were pretty much,
10 after an initial review, they were kicked
11 out.

12 A That's correct. I did not specifically in
13 detail go through anything with any other
14 state commission or company other than that
15 big picture look of what is each state doing
16 and what are some of the companies doing
17 through SGA, AGA and NARUC. So, you are
18 correct, we did not focus in on ten other
19 ones and go through those in detail and then
20 get down to the one. We cut through all that
21 by going through the whole thing and saying,
22 okay, now, which of those can we spend some
23 time looking at because it was primarily
24 myself and John Hall that looked at those.

1 And we don't have a huge corporate staff, I
2 mean, we are pretty much the rate and
3 regulatory staff as well as the financial
4 staff and et cetera, and so, we decided to
5 spend our time on that one and we did.

6 Q Well, let me just go in very briefly to the
7 concept of the Alternative Regulation Plan.
8 The Alabama plan, would you characterize that
9 as a rate stabilization plan or as a
10 performance based rate making plan?

11 A They call it a rate stabilization and
12 equalization plan, and from talking with
13 people down there at the company and the
14 Commission, and looking at it, and looking at
15 the development of it over a period of time,
16 it started, I think, in 1983. So, it has
17 been ongoing now for 16 years, I guess, they
18 are getting ready to head into the 17 year.
19 And it has evolved somewhat, I think, because
20 it has been--it started out, I think, as
21 maybe a three year or four year experimental
22 plan, and then each time it has to be
23 reviewed in proceedings by the Commission
24 before it is renewed. And intervenors have

1 the opportunity to be heard and they go
2 through the whole process. They viewed that
3 as a way, it is my understanding from talking
4 with some of the people there, the Commission
5 and staff, that they viewed this as a way to
6 avoid annual rate cases, avoid the cost of
7 annual rate cases and still have a more
8 streamlined approach to keeping the company
9 within some target return that the Commission
10 and staff and company said is reasonable.
11 And so, it was a way to stabilize rates and
12 to stabilize the process a bit. Otherwise, I
13 think they were just dealing with, as I
14 understand it, continuous annual rate cases
15 that were very expensive. So, there was
16 both, I think both sides of that.

17 Q Well, would the--I'm sorry.

18 A And then that just sort of evolved, you know,
19 over time.

20 Q Would it be your opinion, then, that it is
21 more or less a rate stabilization plan? It
22 is not as much performance rate making as it
23 is to stabilize rates and avoid what we might
24 call the classic war of parties when a

1 company comes in for a rate adjustment?

2 A Well, I think that, as I recall from it that,
3 it maybe started out perhaps more the way you
4 describe, but they have added elements to it
5 that deal with efficiencies and trying to
6 make sure costs are controlled. And that is
7 one thing, you know, when you look at
8 something like that you don't--you could have
9 the ability to just pass through all costs no
10 matter what if you have some controls on
11 those to provide incentives, and I think
12 theirs does both. And I think that what we
13 propose does both, it is not just strictly a
14 way to stabilize or to streamline but it is
15 also a way to have some cost controls. Now,
16 you can argue all day, depending on who you
17 are talking with, about whether those are the
18 right controls, or you need different
19 controls, but we proposed what we thought
20 were reasonable controls based on what we saw
21 with them and what we see with Delta Gas.

22 Q Would you agree with the statement that
23 Delta's experimental plan appears to be
24 modeled on I guess the first or second

1 generation of the Alagasco plan as opposed to
2 the more recent versions that have been
3 approved by the Alabama Public Service
4 Commission?

5 A I--I tell you, I would have to go back and
6 look at those and I haven't gone through each
7 one of those. So, it would be hard for me to
8 answer that yes or no.

9 Q Okay, well--

10 A I'm sorry I--

11 Q That's okay.

12 A I'd be glad to look at them and compare them
13 but I just--I had the general understanding
14 from them and I did, you know, look at where
15 they were and where they evolved to, but they
16 did over time make changes and the Commission
17 and the company people told me that over time
18 in these three or four year proceedings that
19 they did continue to refine it because they
20 started out with it as an experiment. And
21 each three or four year period they refined
22 it. If they saw something in it that they
23 didn't think was working over that three or
24 four year period, then they tried to change

1 it. And that's, you know, what we--we had
2 some discussions up here, conferences where
3 the AG was involved and the staff, and talked
4 about this. You know, that is our approach
5 as well. You start with something on an
6 experimental basis, we propose three years in
7 this proceeding. In that proceeding, which
8 was a different proceeding, which is now
9 folded into this proceeding, I guess is--to
10 be more accurate, and we are perfectly
11 content with that review at the end of that
12 period of time. And adjustments that need to
13 be made to it, we were perfectly willing to
14 work with and negotiate with the AG and the
15 Staff and made that very clear back in, you
16 know, the early part of this year to try to
17 work towards something that would need to be-
18 -that would suit everybody and something that
19 could then be looked at in three years and
20 further massage it if it needed be, because I
21 think it is an ongoing process.

22 Q Well, to the extent that, I guess you relied
23 upon the experiments that were conducted in
24 Alabama and the process that went through

1 there, the subsequent changes and evolution
2 of a plan, would you say that the evolved
3 plan would probably be a better model than
4 the first generation?

5 A Well--

6 Q When I ask that I ask that as far as Delta
7 Natural Gas Company using either the evolved
8 model or the original model for its starting
9 point?

10 A One thing, one thing that I really like about
11 theirs is the rate of return they have in it.
12 And if that were the model that the
13 Commission wanted to use, it is the--I talked
14 with them last night, it is a low side of
15 13.165, mid point of 13.4 and high side of
16 13.65, I believe that is correct, and that, I
17 think, gives them the opportunity to stay
18 solvent and pay their dividends and we have
19 not had that luxury. But now, in answer to
20 your real question, which was--

21 Q Let me rephrase it, so I haven't forgotten
22 it.

23 A No, I--

24 Q Let me put it this way, if you--which is

1 better, the first version or the current
2 version of the Alabama plan?

3 A Well, I tell you what I think is best, I
4 think the Delta filed version is best.

5 Q Well, unfortunately that wasn't in the
6 selection.

7 A I realize that but we are also not trying
8 this proceeding in Alabama. So, you know,
9 what we did was we took what we saw with
10 them, looked hard at Delta Gas, looked at its
11 expenses, its operations, its environment and
12 said, okay, what do we think we are willing
13 to propose for Delta Gas and its customers?
14 What do we think will work and that is what
15 we did. And I can't evaluate whether
16 Alagasco's in every minute detail of where it
17 was and where it is is absolutely best. All
18 I can say we took it, we used the basics of
19 it and we put controls in that we thought
20 were reasonable, and we are more than willing
21 to discuss in trying to negotiate those with
22 Staff and the AG, anyone else that
23 intervened. I mean, at that time that was
24 the only two involved, and we still just want

1 to get something that is workable and
2 reasonable that everybody feels like is
3 reasonable like they have in Alabama and go
4 forward with it. But we would have to work
5 within the environment we are in here, not
6 the environment that they are in there.

7 Q Okay. Given that you have the current
8 Alagasco model and then you adapted it to
9 meet Delta's needs, what provisions of the
10 existing Alagasco plan were deemed to be
11 unsuitable for Kentucky and why?

12 A Well, the one thing that comes to mind, I
13 don't remember all of them, I guess I'd have
14 to go through and compare it in detail, but
15 the one thing that comes to mind is the
16 settle up part of it. When we looked at
17 theirs they would adjust rates once a year
18 based on their budget and then as they would
19 go on through the year there was no provision
20 to ever, in effect, make whole, like there is
21 on the PGA. And we said well that is
22 something that we think needs to be done from
23 both sides. You know, if you, in effect,
24 estimate what your revenues are going to be

1 and your return and then adjust to some
2 target return at the end that you say is
3 reasonable from both the Commission and the
4 company standpoint, then you need somehow to
5 be able to eventually bring that to closure
6 and be whole with it. And that's the one
7 thing that really comes to my mind that is a
8 significant difference, I think, from what
9 they do. And I just said, you know, if I
10 were doing it what do I think is reasonable
11 from both sides. And I am a Delta ratepayer,
12 I live in Berea and I pay Delta's rates and,
13 you know, I don't want those to be any more
14 than I want Berea College's electric rates to
15 be.

16 Q So, your testimony is that the only provision
17 that you are aware of right now that you can
18 recall that has been dropped or that has been
19 added is instead of using the--there is an
20 addition of a settle up provision in the
21 Delta proposal that is not in the Alagasco
22 plan?

23 A I said that that was the most significant
24 one, I believe.

1 Q Uh-huh.

2 A So, if you will give me just a minute and let
3 me think about it. The--the, I guess you
4 could call it the PBR piece, the expense
5 comparison on looking at adjusting for O&M, I
6 believe that our test on that is a little bit
7 more than the test that they have. It seems
8 to me that the--we also put a revenue cap on
9 it like they had done, and I believe our
10 revenue cap is 5% versus, I think theirs is
11 4, I'd like--I need to review it to be sure,
12 but that comes to mind. And the band, the
13 band on O&M, the dead band during which you
14 don't adjust is--I think ours is 1.5% and I
15 believe theirs is a little bit different.
16 That may be 1.25 sticks in my mind, but I
17 don't have both of them in front of me, if I
18 did I could sit there and compare them.
19 Those are two things that I recall.

20 Q Do you--is there any reason for those
21 differences?

22 A Well, the only reason that we have was that
23 we felt like what we proposed, the band that
24 we proposed, the adjustment with the CPI and

1 the revenue cap were things that would make
2 it where we could live with it and where when
3 we got this in place and worked through it
4 for a three year time frame that we would
5 have a reasonable opportunity to earn some
6 target band of return with it. If we were
7 more efficient or less efficient, we would
8 eat some of that or we would share that with
9 the customer, you know, that there would be
10 sharing and that that was reasonable and fair
11 for our situation. And then we also--there
12 was also an equity capitalization percentage
13 there, ours is 60% and I don't remember
14 theirs, theirs may be the same, I'm not sure
15 on that one. Those are things that come to
16 my mind as I think through.

17 Q Okay. You had mentioned that one of the
18 benefits of this Alternative Rate Regulation
19 Plan is you don't have to come in here very
20 often, or at least as frequently for a rate
21 adjustment case, that the expense of a rate
22 adjustment proceeding is avoided. And I take
23 it that is a major part of the benefit of the
24 plan, at least in Delta's eyes. Would that--

1 A Well, that was characterized to me by people
2 at Alabama Commission and the company that
3 that was one of the benefits that they
4 experienced is, you know, not having rate
5 cases every year. And we talked about this
6 last night, John Hall and I did, you know, as
7 we look at this case, you know, we are going
8 to be somewhere upward of \$250,000 in this
9 case in just outside costs and that doesn't
10 include enormous amount of inside costs. And
11 what happens in our company with John and I
12 and some other people involved with a case
13 like this is it takes away time to manage.
14 You know, it takes away time that you deal
15 with problems and the opportunities that are
16 there, so that is a hidden cost. And so,
17 those are, for us, very significant, they
18 really are.

19 Q Would you agree that when you come in for a
20 rate case you basically have to submit a
21 tremendous amount of information both to the
22 Commission and to interested parties to
23 justify your existing or your proposed rates?
24 You basically have to throw open your books?

1 A Well, yes, you don't have to, it depends on
2 what they ask. But, historically, we have
3 been asked a lot--we've been asked for a lot.

4 Q You've been asked for a lot.

5 A That doesn't have to be the case, but--

6 Q Now, in the most recent Alabama Public
7 Service Commission Order allowing for a
8 continuation and modification of the Alagasco
9 plan, they talked about some staff of that
10 commission becoming very familiar with the
11 operations of the utility. Do you foresee
12 that you are going to be substituting a
13 periodic throwing open your books to one of
14 almost constantly having review by the
15 Commission or other interested parties?

16 A No, I hadn't--I guess I hadn't really
17 reflected on that. I'm assuming you are
18 probably talking about Bob Reed that works
19 for the Alabama Commission. I've talked with
20 Bob and Bob does have familiarity with
21 Alagasco's operations and systems and costs,
22 at least the last time I talked with him he
23 seemed to. But I don't view that as
24 unhealthy for the Commission or the company.

1 It seems to me that if the end result is that
2 you are reasonably have the opportunity to
3 earn that return band and the staff feels
4 good about where you are and you feel good
5 about it and you feel like your customers are
6 being treated fairly, then I don't see
7 anything wrong with that.

8 Q Well, does it--

9 A So, Staff and the companies and intervenors ought
10 to all work toward the same goal, it seems to me,
11 of reasonable profits and good service.

12 Q Are you simply substituting, though, a more
13 spread out review period for a compressed
14 period? You throw open your books in a five
15 month proceeding in a rate adjustment case as
16 opposed to one where interested parties and
17 the Commission are reviewing your records on
18 a periodic basis, reviewing the estimates for
19 your budget, reviewing your operations?

20 A You see, I don't--I don't--I have to disagree
21 with you, I don't characterize the process
22 the way you are. We always have viewed that
23 our books and records are always open to the
24 Commission and the staff, I mean, any time

1 they want to come in and look at anything we
2 don't refuse or decline and we try to work
3 with them, and we couldn't refuse and decline
4 if we wanted to, by law. I mean--so, that
5 process is always there and in place if they
6 want it to be. For instance, the management
7 audit that went on for a couple of years,
8 I've never, to my knowledge, been through a
9 more intense scrutiny than that, personally
10 as well as with the company. So, you know,
11 we are used to that and I'm not sure that we
12 have really defined how intense that annual
13 scrutiny needs to be on the Alt Reg proposal.
14 I guess it can be--our thought was to work
15 with the Commission and the staff and
16 determine that, determine that level that
17 they felt was necessary and important and
18 they were comfortable with, and we are
19 willing to do that. We said that a year ago
20 when we started talking about this. I know
21 part of the concern is the budget and, you
22 know, reviewing the budget detail and input,
23 et cetera. I've discussed that with people
24 in Alabama to see how it is handled down

1 there and they have a very intensive review
2 by management and their board just like we
3 do. And since they are a public company as
4 well as we are and subject to the SEC and
5 other rules and requirements and scrutiny,
6 they feel like their Board and management
7 really looks hard at their financial plans
8 and financial commitments and financial
9 goals. We feel the same way. And we think
10 that whole process ends up with a much more
11 detailed and viable budget with good
12 decisions made as you go through it, than you
13 do in a non-public company. So, I think that
14 is worth a lot but, you know, the staff--we
15 have had some staff discussions early on as
16 we were having these meetings and just
17 talking about this whole concept before we
18 even filed anything. Delta Gas is receptive
19 to whatever we can work out on the level of
20 that review. Whether it will take more or
21 less, I don't know, maybe in the first year
22 it might, but it seems to me over time that
23 the comfort level with the whole process
24 would either be there or it wouldn't. And if

1 it wasn't, after the three year experiment if
2 the Commission staff just said we are never
3 going to get comfortable with this, then they
4 don't renew it. But if they do, then maybe
5 they fine tune it to where they get more
6 comfortable with the process. It seems to me
7 you have to work through that and I don't
8 have all the answers to it, but I'm committed
9 to try to do it.

10 Q Well, how frequently does Alagasco, how
11 frequently is it reviewed by the Alabama
12 Public Service Commission or its staff?

13 A Well, I know that they file information with
14 them at the start and I just don't--I don't
15 recall the frequency of that. I discussed it
16 one time with them but it seems to me like
17 maybe it is quarterly, but it may even be
18 monthly, I don't--

19 Q Okay. I'm told that it is monthly.

20 A Okay, it could be, I honestly just don't
21 recall. I know that there was some periods
22 that they would stop and look at it. And I
23 know Bob Reed is the staff person that does
24 that, or was doing it the last time I talked

1 with him. You know, they are also a larger
2 somewhat more complex company than us and
3 maybe he feels like he has to do that more.
4 We are a small rural company, we might, you
5 know, the staff is very knowledgeable and
6 experienced, they might be able to just--to
7 handle it maybe different than he does.

8 Q Well, based on your knowledge of the Alagasco
9 plan, would you say that the Alabama plan
10 would be as effective without the monitoring
11 and oversight that they currently have in
12 place if they didn't have monthly reviews?

13 A You know, from my perspective, I think it
14 would, because I think that is the reason to
15 have the performance measures and the cost
16 controls and the target band that the
17 Commission and staff are comfortable with.
18 If you have all those things in place, I
19 don't see a lot of other things influencing
20 that, you know, I just don't. If there is a
21 concern that the company is fraudulent or
22 mismanaging, then I'd say management audits
23 are the place to deal with those things. But
24 without that, and if you have the filings

1 that are made and if the budget information
2 looks reasonable, I mean, you know, you can
3 quickly look at it and if things suddenly are
4 way out of line with where they have been,
5 then question those things, it seems to me
6 that that could be done fairly easily.

7 Q Did you have any discussions with the Alabama
8 Commission on what they thought about
9 monitoring, what they felt was an appropriate
10 level of monitoring?

11 A No, I discussed with Bob Reed not long ago if
12 he--you know, how he felt about the process
13 with a person from Alagasco at the time. And
14 I got the feeling that they were comfortable
15 with it, but I didn't ask him in detail what
16 he does month to month or day to day with it.

17 Q And Bob Reed is what, the Chairman of the
18 Alabama--

19 A No, Jim Sullivan is Chairman of the Alabama
20 Commission. Bob Reed is a staff person that
21 is on the staff and it is my understanding
22 that he has been assigned, amongst other
23 duties, responsibility for overseeing the
24 Alagasco program from the staff standpoint.

- 1 Q Do you know how many people the Alabama
2 Commission--on the Alabama Commission staff
3 are assigned to do monitoring?
- 4 A I do not. It is my understanding from
5 talking with those people that Bob Reed is
6 the person. But now whether he has other
7 people with him or under him that assist him,
8 I have no knowledge of that.
- 9 Q Let me refer back to your testimony while we
10 are still on the Alternative Regulation Plan.
11 In your testimony you state that the proposed
12 plan would--allows or shares the risk and
13 reward of efficiencies with Delta and its
14 customers.
- 15 A What page are you on?
- 16 Q I am referring to page 11 of your testimony.
- 17 A All right.
- 18 Q At line 20.
- 19 A Okay.
- 20 Q Okay, do you have that?
- 21 A Yes, sir, I do.
- 22 Q Okay. Can you tell us what are the rewards
23 for the customer under this plan? What do
24 the customers get out of it?

1 A Well, the thing that we saw is--well, for one
2 thing is the cost of going through rate
3 proceedings that doesn't--you know, that gets
4 borne by the customer now either in the
5 operations year or spread out depending on
6 the amortization period. And that is one
7 fairly significant benefit that we see. And
8 the other benefit that I can see is right now
9 the way, under our current rate case
10 approach, if we file a rate case and we did
11 not have anything like this, and let us say
12 that we were very efficient or just reduce
13 cost arbitrarily and service may be worsened
14 but the bottom line was good, and the return
15 was much greater than a band of return that
16 was found to be reasonable, then service
17 would suffer, customers would suffer on not
18 having the service and we could probably try
19 to take steps to enhance our return just for
20 that purpose and that alone. Under this
21 approach, when you do that, the rates come
22 down to reflect getting back to that band of
23 return and I think that is fairly
24 significant. And the same way with weather,

1 if you have a year when it is 10 or 15%
2 colder than normal and your return would be
3 much higher as a result of that, that now
4 adjusts back under something like this so
5 that benefit passes back to the customer
6 instead of being retained by the company. I
7 think those are some fairly significant
8 things that could be benefits to the
9 customers, in addition to the cost savings.

10 Q Under the existing system of regulation,
11 though, if your--if Delta's service
12 deteriorated, would not the Commission have
13 the authority to come in and require
14 corrective action? Isn't that always
15 available under the present system?

16 A That is always available.

17 Q And I take it that if a customer, whether it
18 be a large customer or small customer, filed
19 a complaint, they could go ahead and seek
20 redress from the Commission either informally
21 or formally?

22 A That's correct.

23 Q So, I'm not quite sure I understand the
24 benefit, at least as to service standards?

1 A Well, what would be the time frame on
2 something like that occurring? It would not
3 be instantaneous. There would be some time
4 lag involved and that time lag may stretch
5 over a long period of time. It seems to me
6 this would be more reactive. I mean, you
7 would--if that happened at least you could
8 see the reduction in rates rather quickly
9 through the process. And I haven't seen a
10 lot of proceedings where companies were
11 brought in for overearning or for poor
12 service, or maybe it is on a specific issue,
13 but it seems to me that this is a way to
14 really focus the whole process back to good
15 service and if things affect rates, to force
16 them back to rates fairly quickly, at least
17 in this case on an annual basis. And I just
18 view that as a positive sort of thing. As
19 long as you feel like, you know, you feel
20 like the expenses are not unreasonable and
21 that the return band makes sense. I mean, I
22 don't see how the customers are harmed by
23 that. I really think they have more up side
24 and no down side.

1 Q Okay. Let me switch gears for a few minutes
2 and turn to Mt. Olivet Natural Gas Company.
3 Has Delta concluded its acquisition of Mt.
4 Olivet?

5 A No, sir.

6 Q When does Delta expect to conclude it?

7 A Real soon. We had the same thought six
8 months ago, though, that it was going to be
9 real soon, but we anticipate real soon. We
10 hope in the next week or two.

11 Q Okay.

12 A We hope. I certainly hope.

13 Q Is the recovery of the Mt. Olivet Natural Gas
14 Company plan acquisition adjustment included
15 in this current rate case proceeding?

16 A To my knowledge, there is nothing in this
17 rate case proceeding dealing with Mt. Olivet,
18 to my knowledge.

19 Q Okay. And in your opinion, should any
20 adjustments to Delta's rate to reflect the
21 acquisition of Mt. Olivet be postponed until
22 such time as the acquisition is completed?

23 A Quite frankly, you know, whether Mt. Olivet
24 is in this case or not in this case it is

1 very insignificant to the case. I mean, when
2 we went through the proceedings with Mt.
3 Olivet here and went through all the numbers
4 and the data and it is about a wash. I mean,
5 there may be a little benefit to including
6 it, but it is very insignificant in the big
7 picture of things, as I recall, a few
8 thousand dollars. And, you know, our
9 position has always been once Mt. Olivet gets
10 acquired then, you know, if the Commission
11 wanted to roll it in, roll it in. I just
12 hate to roll it in until we actually own it.
13 I would like to at least own the properties.

14 Q Okay. Well, I guess my question then is, is
15 your answer to the last question yes or is it
16 no?

17 A Oh, man, let's see, what was the last
18 question? Could you repeat the last
19 question? Was it should it be rolled in or
20 shouldn't it or when should it be rolled in?

21 Q Should it be rolled in or should it be
22 postponed until the acquisition is completed?

23 A Well, I would say if we can get it closed
24 soon so that it can be incorporated into this

1 proceeding I wouldn't--this is not the
2 question but I would encourage fairly rapid
3 movement on this whole case here because I
4 really, you know, feel like Delta really
5 needs some rate relief in this proceeding.
6 And I would not want Mt. Olivet to hold that
7 up, but if it happens soon, I mean, what we
8 have always tried to do in rate cases if
9 something is known in time to adjust it into
10 something, I think we have tried to do that.
11 And I think Mt. Olivet is probably the same
12 way. I mean, it--so the answer is yes if it
13 is timely enough. You know, we are trying to
14 push ahead with it. I'd really like to push
15 ahead with it so I could quit messing with
16 it.

17 Q Do you agree that at some point in time Delta
18 should transfer the recovery of cost of its
19 Canada Mountain storage assets from the gas
20 cost recovery mechanism to general rates?

21 A Your question was do I agree with that?

22 Q Do you agree with that statement?

23 A Yes--no, I don't agree with it, but I don't
24 necessarily disagree with it. Now, do you want me

1 to elaborate or just stop there?

2 Q Well, you've been elaborating all day, so I
3 won't stop you right now.

4 A Well, you can stop me whenever you want, that is
5 your call. If you don't want me to go into it any
6 further, I won't.

7 Q If you could explain your answer for us why--
8 well, let's move back for a second, is it yes
9 or no, do you agree with that statement or
10 disagree with that statement?

11 A I can express no opinion either way on that
12 statement just as a yes or no.

13 Q Well, no, I'm going to follow up and ask you
14 for an explanation.

15 A Oh, okay.

16 Q So, I'll give you the opportunity to explain,
17 yes or no?

18 A I don't care a whole lot because--now, can I
19 elaborate?

20 Q Sure.

21 A Because--

22 VICE CHAIRMAN HOLMES:

23 Can you give them a yes or no and then
24 elaborate?

1 A No, that's not--but, you know--okay, let me think
2 about it a minute.

3 CHAIRMAN HELTON:

4 Mr. Jennings, maybe I was a little
5 negligent this morning when we started
6 this proceeding because we have been
7 announcing it every hearing lately, that
8 we would like a yes or no answer from
9 the witness and then they can elaborate.

10 A Okay.

11 CHAIRMAN HELTON:

12 And we won't have to go back and ask
13 these questions over again--

14 A I understand.

15 CHAIRMAN HELTON:

16 --and we won't have to spend a lot of
17 time rehashing things if you will give
18 us a yes or a no, not an either or.

19 A Okay.

20 CHAIRMAN HELTON:

21 A yes or no and then explain your
22 answer.

23 A Thank you. I understand that and I
24 appreciate it. My counsel admonished me last

1 night to be sure and do that and--because he
2 gets tired of my long winded answers too, so
3 I appreciate that.

4 CHAIRMAN HELTON:

5 You can object.

6 A The--okay, the answer is no. But I don't
7 like to give yes or no answers unless I can
8 elaborate on them. That's what my concern
9 was.

10 VICE CHAIRMAN HOLMES:

11 You can elaborate.

12 Q Before you elaborate let me ask you the next
13 question then. Why should Canada Mountain costs
14 remain in Delta's gas cost recovery mechanism?

15 A Okay. That brings me to the rest of my
16 answer then.

17 Q Yes, it does.

18 A When we decided to develop Canada Mountain I
19 thought that made sense because we had to
20 have supply in our system. We had to have
21 system supply. We said as we looked at the
22 cost of developing Canada Mountain that it
23 was going to be a three or four year program
24 and we could either embark on filing rate

1 cases once a year, or maybe even more often
2 because of the cost involved with that and
3 the fact that we could not bear that if we
4 didn't have some means of recovery of that.
5 And we approached the staff and talked about
6 this for a long period of time about, you
7 know, this approach of doing it through the
8 GCR because Canada Mountain is a gas supply
9 cost. It is no different than the interstate
10 pipe line capacity that we have on Columbia
11 Gas and El Paso or Tennessee, it is no
12 different. When we went through the 636 and
13 436 settlements at the FERC on those
14 pipelines we obtained flowing capacity and
15 storage capacity on those pipelines, and that
16 has historically always gone through the GCR
17 as a gas supply cost and still does. Canada
18 Mountain is another way for us to supply our
19 needs on a peak day in a winter time basis.
20 The only alternative to that was building
21 significant and more costly pipelines to the
22 interstate pipelines and then not having the
23 ability to arbitrage pricing. So, we saw a
24 lot of benefits to our customers from this to

1 manage supply, and that is the way it is
2 working. So, we then propose and it was
3 agreed that we could recover that through the
4 CGR as we developed that field, otherwise, we
5 would have filed rate cases once a year.
6 Now, in retrospect, sometimes you get--I've
7 been reminded of this, you sometimes get what
8 you ask for--and maybe we would have been
9 better off filing those annual rate cases but
10 in retrospect we didn't, so I can't go back.
11 But now we find ourselves with a field that
12 is developed and it seems to me that the
13 method that is being used is reasonable,
14 considering the nature of the cost, which is
15 a gas supply related cost. That is the focus
16 of Canada Mountain, that is what it is there
17 for. I also think that you need to think
18 hard about that because the way we view
19 Canada Mountain, you know, from this point
20 forward with not much more development costs
21 associated with it, you are going to have
22 annual depreciation and over time the rate
23 base, if you want to use that term, is going
24 to, all things being equal, decline as you

1 depreciate it out. Are you with me on that?
2 So, I'm not sure if I were in your shoes or
3 the customer's shoes I would say let's roll
4 it over into rate base, because, you know, if
5 you don't make sure it is handled right over
6 there in rate cases in the future, or
7 whatever proceeding you have, then that
8 won't--it might not roll back as quickly to
9 the customers as that investment that is
10 written off. Now, if you have--I'll go the
11 rest of the story, if you have an alternative
12 regulatory approach in place, then that will
13 be taken care of through that process. So,
14 if you have an alternative regulatory
15 approach that works then you could pull it
16 out of there and still be assured that it is
17 going to roll back to the customers over
18 time. Are you with me or do I need to go
19 further on that?

20 Q I think you've answered--

21 A Okay. And that is why I think you need to
22 think very hard about that and, you know,
23 from our perspective if you drop it in base
24 rates and then don't adjust those again for a

1 long time, you know, we could be overearning
2 on Canada Mountain. Right now we are not
3 because we are only earning on Canada
4 Mountain the return that is given to us in
5 the rest of our rates. And that's what we
6 use in the GCR is that same allowed return.
7 So, you know, I think it is pretty fair, and
8 it is gas supply related, so.

9 Q In your--in Delta's discussions with both the
10 Commission staff and in its dealings with the
11 Commission, was there ever any representation
12 made that the process of allowing recovery of
13 the costs through the gas cost recovery
14 mechanism would be permanent? Or was that
15 simply to be a temporary expedient which at
16 some point would switch over to general
17 rates?

18 A I don't remember very much ever on any
19 discussion with anybody about anything that
20 is meant to be permanent. It is just until
21 the next case or the next proceeding or if
22 the Commission changes its mind or wants to
23 reconsider it differently, I mean, just to be
24 honest. And so, I certainly didn't consider

1 anything about Canada Mountain to be
2 permanent and forever, except for one thing,
3 we own the storage in the ground and it is
4 there and it is not going to go anywhere.
5 So, that part of it is permanent. But the
6 recovery process of it is--that is always
7 subject to be considered. And I think the
8 concept with the staff was at least that was
9 a starting point to have a means to recover
10 on it as it was developed. Again, I'm just--
11 just caution you that you have a way in place
12 that insures that only a return is earned on
13 the investments made and the actual operating
14 cost and you have a way of being assured that
15 as that rolls down or reduces that it is
16 reflected in rates on a current basis, and
17 that is something I think you ought to think
18 hard about as a staff and a Commission before
19 you change it because it works and its fair.
20 And I just want to point that out.

21 Q The Commission Staff has a few more questions
22 but if we could have a brief five minute
23 recess or ten minute recess so we can get
24 them together, our questions should be fairly

1 quick.

2 CHAIRMAN HELTON:

3 We'll take our break, ten minutes.

4 (OFF THE RECORD)

5 CHAIRMAN HELTON:

6 Mr. Wuetcher.

7 MR. WUETCHER:

8 Thank you, Your Honor.

9 Q Mr. Jennings, I'll try to finish up quickly.
10 Let me first ask a question concerning the
11 applicability of the Alternative Regulation
12 Plan. When Delta first made its filing in
13 Case 99-046, one of the provisions in its
14 filing it stated, and I'll read it to you, it
15 simply says "If modifications are made to the
16 proposed alternative rate making mechanism,
17 Delta respectfully reserves the right to
18 either choose to implement the modified
19 version or to continue to remain under
20 traditional regulations." Now, can you
21 explain that for us? Does that mean if you
22 don't--if Delta doesn't like what the
23 Commission does it is not going to implement
24 the plan at all if the Commission tinkers

1 with it?

2 A That was our--I guess that was the thrust of
3 our remark, that's why we made it. I don't
4 know that that is exactly what we meant by it
5 the way you have characterized it. I guess
6 our thought was that we have the traditional
7 regulatory approach and we understand that
8 and we understand how that works, and we
9 understand the Alt Reg proposal that we made
10 and we understand how it works, and we
11 choose voluntarily to file the Alt Reg
12 proposal as opposed to or in addition to the
13 traditional regulatory approach without
14 understanding the framework that we might end
15 up with afterwards. And it was our thought
16 that, you know, what we propose we can live
17 with--we might be able to live with what we
18 get but we might not, and we'd like to have
19 the choice of just staying with traditional
20 regulations if we can. And that is why we
21 said that.

22 Q Let's explore that for a second so we all
23 know what way we are all reading from the
24 same page. Let's assume for a moment that

1 the Commission modifies the plan, issues a
2 Final Order, is it Delta's position at that
3 point that it will either object or withdraw
4 the Alternative Ratemaking Plan in toto and
5 just continue to follow under traditional
6 plans?

7 A Well, that is one way to resolve it. Another
8 way would be to have a conference and try to
9 work it out.

10 Q Okay. Well, I'm just--okay, granted--

11 A We'd like--you know, we'd like nothing better
12 than that. I mean, we wanted that early on.

13 Q I mean, I'm just--I'm looking at just the
14 final end result. Assuming for a moment
15 there might be additional conferences and
16 rehearing and what not, does this--let's take
17 a second scenario, assume the Commission
18 modifies the plan but approves it, does that
19 mean--well, let me step back for a second.
20 During the three year period in which Delta
21 proposes to have the experimental plan in
22 effect, I assume Delta will not be filing any
23 type of general rate adjustment proceeding?

24 A I don't know about that, I hadn't really

1 thought about that.

2 Q Okay. So, there would possibly be some
3 circumstances where even though this plan is
4 in effect Delta would still come in for a
5 general rate adjustment?

6 A Well, I'm just trying to think, you know,
7 maybe rate design concerns perhaps, I don't
8 know how we could modify rate design if we
9 felt like we needed to, from a market
10 standpoint or competition or pricing
11 standpoint. The only way now that we can
12 address rate design issues is, seems to me,
13 to be in a rate proceeding. Am I correct on
14 that, I can't think that that is--

15 Q Well, let's clarify that so we make sure that
16 we understand. You are talking about Delta
17 may come back in if there are modifications,
18 well, if the experimental plan is approved
19 Delta might still come back in to make
20 changes to its rate design but those would be
21 "revenue neutral" as opposed to change--that
22 the revenue that Delta would be getting from
23 the new proposed rates would simply
24 redistribute what they are already authorized

1 to get?

2 A I could not--that is one that I can envision.
3 Right now, off the top of my head, I can't
4 envision other things that would require us
5 to do that, you know, because you have dealt
6 in return and O&M and, you know, capital and
7 all those things.

8 Q So, aside from some type of reconfiguration
9 of the rates for rate design purposes only,
10 Delta would not be coming back in for rate
11 adjustment to increase the amount of money
12 that is coming back in under the experiment--
13 if the experimental plan is approved?

14 A If it is approved as filed or as it--

15 Q Well, let's take for a moment if it is
16 approved as filed?

17 A I think that is an accurate statement, what
18 you said is an accurate statement.

19 Q Just so that we can--we are all on the same
20 sheet of music still, I assume that that
21 waiver of any general rate adjustment filing
22 is in absence of some extraordinary event,
23 let's say an earthquake occurred in eastern
24 Kentucky and you had to generate enough

1 revenue to rebuild your system?

2 A Well, I was going to elaborate on that just--
3 I can see some things happening like that or
4 fairly catastrophic things that have to be
5 dealt with.

6 Q Okay.

7 A Where your expenses might be outside the
8 band, you know, the cap, you know, so that
9 you--because of things that are just
10 completely outside of your control.

11 Q Okay, but you are--

12 A We don't usually have a lot of things like
13 that, earthquakes would be one.

14 Q So, not trying to continue to beat a dead
15 horse, but if the Commission accepts the plan
16 as proposed, Delta would not come back in for
17 a general rate adjustment except for the
18 limited purpose of reconfiguring its rates
19 for rate design purposes or it would not come
20 back in unless there is some extraordinary
21 event that would require a rate adjustment
22 for additional revenues outside what is
23 envisioned by the Alternative Regulation
24 Plan?

1 A I believe that is an accurate statement. I
2 agree with you.

3 Q All right. Okay. Let's take that as as
4 given, now, and go back to our original
5 example and I had said assume for the moment
6 the Commission modifies the plan. Now, one
7 scenario based on this statement in here is
8 that Delta could say at the time the
9 Commission issues its order we are not going
10 to--we don't expect that we want to be
11 regulated under the traditional rate making
12 method, is that how Delta is envisioning
13 this?

14 A Either that or we could say, you know, we
15 have a real problem with this amendment you
16 have made to it, can we work this out with
17 the Commission Staff and intervenors, can we
18 try to negotiate something that we and you
19 can live with.

20 Q Okay. Assume for the moment--

21 A I don't know what the forum would be for
22 that.

23 Q Assume for the moment your efforts to get
24 modifications to the Commission's Order are

1 unsuccessful.

2 A Okay.

3 Q Okay. So, Delta would step out of the plan,
4 or step out of the Alternative Plan once it
5 got a final Commission's Order modifying the
6 plan, is that what that language represents?

7 A That is correct, that was our hope. I mean,
8 that was our desire that if we got something
9 that we said, you know, this is worse than
10 where we were and we are already in bad
11 shape. You know, we would just try to move
12 away from it.

13 Q Now, so I'm clear and the record is clear,
14 that Delta would make its withdrawal from a
15 plan as soon as the Order is final or when
16 its rights to appeal have been exhausted?
17 And before you answer, let me give you the
18 other scenario so that it will make it easier
19 for you to answer. We are not talking, are
20 we, about the possibility that Delta would
21 accept the modifications to the plan and then
22 at some point say this is not working out,
23 you have modified it, the three years have
24 not passed, there has been no extraordinary

1 event but we want an additional rate
2 adjustment and we are not bound by any type
3 of prohibition against a general rate
4 adjustment in those three years?
5 A Was that a question?
6 Q It was. It was kind of like an answer, it
7 was pretty long.
8 A Okay. I was with you there up to a point and
9 then I'm sorry I just--
10 Q Well, let me start back to the beginning.
11 You have one scenario, the Commission has
12 issued its order, Delta has exhausted its
13 rights to get modifications or to go back to
14 the original plan.
15 A Got it.
16 Q Delta either opts in or opts out.
17 A All right.
18 Q As Delta has said in its reservation. Is it
19 Delta's position that if the Commission
20 modifies the Order and it does not
21 immediately opt out, at some point during the
22 three year--three years in which the plan is
23 in effect, if Delta sees fit, it could still
24 opt out of a plan and file for general rate

1 adjustment?

2 A Oh, I see, I see the question now. No, I
3 think our position all along had been once an
4 order is rendered in the Alt Reg if it is
5 different than what we filed we would have to
6 evaluate it right then and say is that
7 something we can live with or not. We'd like
8 the opportunity to do that and that's why we
9 asked for it the way we did. But it would be
10 at the time that an order is issued in it.
11 And if we had problems to either, I guess,
12 seek rehearing or to request a staff
13 conference or whatever venue we decided to
14 choose at that point to try to resolve it, or
15 if it was just at a point where we thought
16 well it is not going to be able to be worked
17 out, then just say, okay, we request to
18 withdraw it and stay on traditional
19 regulation.

20 Q Okay. So, there is no continuing reservation
21 after the Commission issues an Order?

22 A Not the way I had viewed it. That's my
23 understanding of it when we did that and my
24 feeling toward it now is that we would have

1 to call that when the Commission decided on
2 it.

3 Q Okay. Let me get back for a moment, we had
4 talked earlier about the lack of any filing
5 of a rate adjustment proceeding for that six
6 year period between Delta's preceding rate
7 case and the one before that, the six year
8 period between, I guess, '91 and '97. Did
9 the--can you tell us what has changed in
10 management philosophy or in Delta's general
11 condition that would have moved Delta to
12 begin adjusting rates annually when its prior
13 philosophy was not to adjust rates?

14 A When you say--let me just clarify this with you,
15 when you say move to adjust rates annually, we
16 haven't yet, since 1990 or even '97, we haven't
17 moved to adjust annually. Are you talking about
18 prospective with the Alt Reg, is that what you are
19 talking about?

20 Q Let me--yes, let me restate the question a
21 little bit.

22 A I just want to make sure I understood.

23 Q So I understand it, too. You would agree, at
24 least as a general management philosophy from